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Cartoon wars

The battle for free speech

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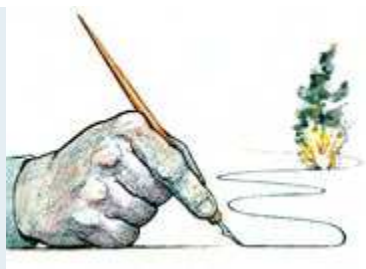
Print Edition February 11th 2006

On the cover

There should be limits to free speech, but the principle is a central value in western societies, and some governments have defended it only feebly: leader



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Politics this week

Feb 9th 2006
From The Economist print edition

AFP

Protests over the republication of **cartoons of Muhammad**, which originally appeared in a Danish newspaper last September, spread across the Muslim world. Danish embassies were attacked and burnt in several capitals, and some countries initiated a boycott of Danish goods. At least ten people have been killed, most of them in Afghanistan when police fired into a crowd trying to storm a Norwegian base. Many newspapers around Europe defiantly chose to publish the cartoons yet again, in the name of free speech. See article

In a sign of growing religious tensions, an Italian Roman Catholic priest was shot dead in **Turkey**. The alleged killer shouted "Allah is great" and later claimed to have been provoked by the newspaper publication of cartoons of Muhammad. See article

The **Italian** parliament passed a tough new anti-drugs law that treats marijuana as severely as cocaine and heroin. The centre-left opposition protested and promised to repeal the law if they win the election in April.

Slovakia's coalition government fell when one of its parties quit after the prime minister, Mikulas Dzurinda, dropped a plan to push through a treaty with the Vatican. Mr Dzurinda promptly advanced the next election from September to June.

A stumble at the first step

Four people were killed during chaotic scenes at a few polling stations during a presidential election aimed at providing **Haiti** with democratic stability. Otherwise, the election organised with UN support passed off peacefully. See article

A presidential election in **Costa Rica** went to a manual recount. After an electronic count of 88% of the votes, Óscar Arias, a social democrat former president, had 40.5%. His unexpectedly strong challenger, Ottón Solís, had just 3,250 fewer votes. Mr Solís is a critic of some aspects of a free-trade deal with America that Mr Arias wants to ratify.

Venezuela's president, Hugo Chávez, expelled the United States' naval attaché in Caracas for spying, prompting the Bush administration to send home the number two at the Venezuelan embassy in Washington, DC. Mr Chávez said he would seek arms in Russia and China. See article

Mexican officials were investigating whether a Sheraton Hotel in Mexico City had broken the law by bowing to pressure from the United States in evicting a visiting Cuban delegation that was due to meet a group of American businessmen. America said the hotel, owned by an American company, had broken its embargo against trading with Cuba.

Stephen Harper, **Canada's** new Conservative prime minister, named a cabinet reflecting a broad geographical spread rather than his own base in the west. He raised eyebrows by appointing a campaign aide to the Senate as public-works minister, charged with making government more accountable. See article

Reuters

At the president's discretion

George Bush presented a $2.8 trillion **federal budget** for the next fiscal year (which begins on October 1st). The proposals continued the pattern of recent years with broad increases in military and security spending coupled with yet more tax cuts and a squeeze on domestic programmes, producing squawks from Democrats and a few Republicans. See article

Alberto Gonzales, America's attorney-general, was grilled by the Senate Judiciary Committee about the use of **domestic surveillance**: he defended the use of surveillance on the ground that America was at war.

John Boehner began his new job as majority leader in the House of Representatives. The Republican congressman from Ohio unexpectedly won the race to replace Tom DeLay, who has stepped down to fight charges of dodgy campaign-finance dealings.

Unfathomable loss

More than 1,000 people died when an **Egyptian ferry** that was crossing the Red Sea from the Saudi port of Duba to the Egyptian port of Safaga with over 1,400 on board overturned after a fire broke out.

A senior official in the **Palestinians'** Islamist movement, Hamas, which is expected to form a Palestinian government, repeated that it would not recognise Israel. Nor, said Khaled Meshaal, would it “accept anybody in the world forcing us into a corner”.

Investigators in **Kenya** said that a former president, Daniel arap Moi, and a former finance minister, George Saitoti, would be questioned in connection with the so-called Goldenberg scandal, dating back to the early 1990s, when non-existent gold and diamonds were said to have been exported, causing huge losses to the Kenyan treasury. See article

Nigeria announced an outbreak of highly pathogenic **bird flu**. Authorities introduced culling, quarantine and control measures. It may be hard to stem the spread of the deadly flu in Africa, where millions depend on poultry for their livelihoods.

King and country

An opposition boycott kept turnout low in local elections in **Nepal** supposedly aimed at boosting the legitimacy of the king, who seized absolute power in a coup last year. See article

A suicide-bomb attack on a Shia religious procession in north-western **Pakistan** resulted in the deaths of 22 people, some of whom are believed to have been killed in riots that followed the attack.

A demonstration estimated to number between 50,000 and 100,000 demanded the resignation of **Thailand's** prime minister, Thaksin Shinawatra. See article

News of an imperial pregnancy threatened to derail plans to open the **Japanese succession** to women, offering as it did the possibility that a male may be born into the imperial line—for the first time since 1965.

Human-rights reports claimed that as many as 10,000 people have been arrested in **Bangladesh** since the beginning of this month, in what is said to be an attempt to halt a mass demonstration of the country's poor.

An international team of scientists reported that they had discovered a **"lost world"** of new and near-extinct plant and animal species—including a new golden-mantled tree kangaroo—in the isolated Foja mountains of (Indonesian) western New Guinea. The magnitude of the biodiversity found in the jungle startled conservationists, who called for the area to be protected.

AP

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Business this week

Feb 9th 2006
From The Economist print edition

General Motors sought to give further impetus to its turnaround programme, cutting its shareholder dividend by half, reducing the salaries of senior executives and board members, and eking further savings from workers' benefits. The proposals were broadly in line with recent recommendations made by Jerry York, an adviser to Kirk Kerkorian who owns 9.9% of GM. (Mr York was given a seat on GM's board the day before the plan was announced.) With a net loss of $8.6 billion last year, the carmaker is battling to stave off bankruptcy. See article

Nortel Networks said it had reached a tentative settlement in two class-action lawsuits stemming from an accounting scandal that brought down senior executives at the firm. The Canadian telecoms-equipment maker will take a charge of $2.47 billion to cover the cash-and-shares agreement.

American International Group reached a much-anticipated settlement of more than $1.6 billion with the SEC and prosecutors in New York. The agreement covers an accounting scandal that has blighted the insurance firm of late and allegations pertaining to bid-rigging in insurance contracts. See article

Samsung Group apologised for a string of scandals that has blighted the reputation of South Korea's biggest conglomerate and said it would make an 800 billion won ($830m) donation to charity as an atonement—part of it paid by Lee Kun-hee, the group's chairman. Mr Lee also said that he will stop opposing new laws that reduce family control of the *chaebol*, South Korea's industrial groups.

Sonae, a Portuguese conglomerate, launched a *euro*10.7 billion ($12.8 billion) bid for **Portugal Telecom**, the biggest-ever offer for a Portuguese company. PT described the action as hostile, but did not immediately reject the deal, which depends on the Portuguese government's waiving of its “golden share”. Investors speculated about a possible counterbid from Telefónica, a Spanish telecoms group that owns around 10% of PT.

Mr Icahn's plan

Carl Icahn formally presented his proposals (prepared by Lazard, an investment bank) for the structure of **Time Warner**. Mr Icahn, a dissident shareholder controlling around 3.3% of the media group, wants to create $40 billion of shareholder value by, among other things, splitting Time Warner into four independent companies. A showdown is expected with managers at May's annual meeting—when Mr Icahn will propose a new board. See article

Univision is considering putting itself up for sale, causing much excitement among investors (the estimated price-tag is $13 billion). The Spanish-language broadcaster, based in Los Angeles, has a booming audience; media giants such as CBS and Viacom, were touted as possible suitors.

Vonage Holdings, which provides “voice over internet protocol” (VOIP) services, filed for a long-

awaited IPO, valued at as much as $250m. The firm, which is unprofitable, had hoped to find a buyer.

Pfizer is considering the sale of its consumer-products division, which includes brands such as Benadryl. With revenues of $3.9 billion last year (accounting for less than 8% of Pfizer's total sales), analysts estimate the unit could fetch $10 billion thanks to the increased profits to be had from non-prescription medicines.

The fall of Rome?

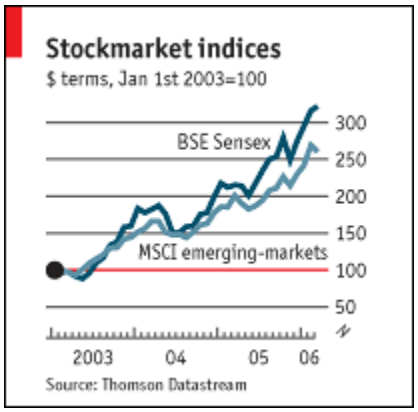
Speculation was rife over further takeovers in Italy's banking sector following the first big merger announcement since Antonio Fazio's resignation as governor of the country's central bank. However, the launch, on February 3rd, of **BNP Paribas's** *euro*9 billion ($10.8 billion) bid for **Banca Nazionale del Lavoro** met with a mixed reaction, as some investors said the French bank was paying too high a price. Banco Bilbao Vizcaya Argentaria, a Spanish bank that had been expected to revive its thwarted offer for BNL, agreed to sell its 15% stake to BNP Paribas. See article

BAA's share price closed up more than 15% after **Grupo Ferrovial**, a Spanish firm specialising in infrastructure, said it was considering a bid for the British airports operator, which has a stockmarket value of some £8 billion ($14 billion). BAA is likely to reject any advance. See article

Aker Yards, a Norwegian shipbuilder, won a *euro*900m ($1.1 billion) contract from **Royal Caribbean Cruises** to build the world's biggest commercial ship. At 360 metres (1,181 feet) long and rising 65 metres above sea level, it will be 43% bigger than the record-holder, *Freedom of the Seas*, which is also being built by Aker Yards. The leviathan is due to set sail in late 2009.

The star of India

The **Bombay Stock Exchange's Sensex index** breached 10,000 for the first time on February 6th. India's surging economy is credited with attracting investors (the Sensex has risen by more than 50% in the past 12 months and outperformed the average of emerging-market exchanges). But analysts warned of overvaluation in the market and pointed to a potential cloud on the horizon—the country's rising current-account deficit.



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The limits to free speech

Cartoon wars

Feb 9th 2006
From The Economist print edition

Free speech should override religious sensitivities. And it is not just the property of the West

AFP

"I DISAGREE with what you say and even if you are threatened with death I will not defend very strongly your right to say it." That, with apologies to Voltaire, seems to have been the initial pathetic response of some western governments to the republication by many European newspapers of several cartoons of Muhammad first published in a Danish newspaper in September. When the republished cartoons stirred Muslim violence across the world, Britain and America took fright. It was "unacceptable" to incite religious hatred by publishing such pictures, said America's State Department. Jack Straw, Britain's foreign secretary, called their publication unnecessary, insensitive, disrespectful and wrong.

Really? There is no question that these cartoons are offensive to many Muslims (see article). They offend against a convention in Islam that the Prophet should not be depicted. And they offend because they can be read as equating Islam with terrorism: one cartoon has Muhammad with a bomb for his headgear. It is not a good idea for newspapers to insult people's religious or any other beliefs just for the sake of it. But that is and should be their own decision, not a decision for governments, clerics or other self-appointed arbiters of taste and responsibility. In a free country people should be free to publish whatever they want within the limits set by law.

No country permits completely free speech. Typically, it is limited by prohibitions against libel, defamation, obscenity, judicial or parliamentary privilege and what have you. In seven European countries it is illegal to say that Hitler did not murder millions of Jews. Britain still has a pretty dormant blasphemy law (the Christian God only) on its statute books. Drawing the line requires

fine judgements by both lawmakers and juries. Britain, for example, has just jailed a notorious imam, Abu Hamza of London's Finsbury Park mosque, for using language a jury construed as solicitation to murder (see article). Last week, however, another British jury acquitted Nick Griffin, a notorious bigot who calls Islam “vicious and wicked”, on charges of stirring racial hatred.

Drawing the line

In this newspaper's view, the fewer constraints that are placed on free speech the better. Limits designed to protect people (from libel and murder, for example) are easier to justify than those that aim in some way to control thinking (such as laws on blasphemy, obscenity and Holocaust-denial). Denying the Holocaust should certainly not be outlawed: far better to let those who deny well-documented facts expose themselves to ridicule than pose as martyrs. But the Muhammad cartoons were lawful in all the European countries where they were published. And when western newspapers lawfully publish words or pictures that cause offence—be they ever so unnecessary, insensitive or disrespectful—western governments should think very carefully before denouncing them.

Freedom of expression, including the freedom to poke fun at religion, is not just a hard-won human right but the defining freedom of liberal societies. When such a freedom comes under threat of violence, the job of governments should be to defend it without reservation. To their credit, many politicians in continental Europe have done just that. France's interior minister, Nicolas Sarkozy, said rather magnificently that he preferred “an excess of caricature to an excess of censorship”—though President Jacques Chirac later spoiled the effect by condemning the cartoons as a “manifest provocation”.

Shouldn't the right to free speech be tempered by a sense of responsibility? Of course. Most people do not go about insulting their fellows just because they have a right to. The media ought to show special sensitivity when the things they say might stir up hatred or hurt the feelings of vulnerable minorities. But sensitivity cannot always ordain silence. Protecting free expression will often require hurting the feelings of individuals or groups, even if this damages social harmony. The Muhammad cartoons may be such a case.

In Britain and America, few newspapers feel that their freedoms are at risk. But on the European mainland, some of the papers that published the cartoons say they did so precisely because their right to publish was being called into question. In the Netherlands two years ago a film maker was murdered for daring to criticise Islam. Danish journalists have received death threats. In a climate in which political correctness has morphed into fear of physical attack, showing solidarity may well be the responsible thing for a free press to do. And the decision, of course, must lie with the press, not governments.

It's good to talk

It is no coincidence that the feeblest response to the outpouring of Muslim rage has come from Britain and America. Having sent their armies rampaging into the Muslim heartland, planting their flags in Afghanistan and Iraq and putting Saddam Hussein on trial, George Bush and Tony Blair have some making up to do with Muslims. Long before making a drama out of the Danish cartoons, a great many Muslims had come to equate the war on terrorism with a war against Islam. This is an equation Osama bin Laden and other enemies of the West would like very much to encourage and exploit. In circumstances in which embassies are being torched, isn't denouncing the cartoons the least the West can do to show its respect for Islam, and to stave off a much-feared clash of civilisations?

No. There are many things western countries could usefully say and do to ease relations with Islam, but shutting up their own newspapers is not one of them. People who feel that they are not free to give voice to their worries about terrorism, globalisation or the encroachment of new cultures or religions will not love their neighbours any better. If anything, the opposite is the case: people need to let off steam. And freedom of expression, remember, is not just a pillar of western democracy, as sacred in its own way as Muhammad is to pious Muslims. It is also a freedom that millions of Muslims have come to enjoy or to aspire to themselves. Ultimately, spreading and strengthening it may be one of the best hopes for avoiding the incomprehension that can lead civilisations into conflict.

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Germany's new chancellor

Angela Merkel charms the world

Feb 9th 2006
From The Economist print edition

The new German chancellor has made a promising start—but bigger challenges lie ahead

Reuters

FEW political transformations have been so quick—or so complete. For years the leader of Germany's Christian Democrats (CDU), Angela Merkel, was rubbished as a dowdy easterner with little experience and less charisma. Her campaign last summer against the more impressive Gerhard Schröder, the Social Democratic (SPD) chancellor, was calamitous, as she frittered away a 20-point opinion-poll lead to finish with a smaller share of the vote than the losing centre-right candidate, Edmund Stoiber, leader of the CDU's Bavarian sister party, took in 2002. Immediately after the September 18th election, there was even talk of dumping her as chancellor-candidate in favour of an up-and-coming CDU state premier.

But this was to forget one enduring lesson of German politics in the past decade: never underestimate Ms Merkel. In 2000, she ruthlessly pushed out her predecessor as CDU leader, Helmut Kohl. She went on to brush aside challenges both to her party leadership and to her prospective candidacy. Between September and November of last year she patiently negotiated a “grand coalition” deal with her SPD opponents, helped by a disgruntled Mr Stoiber's decision to retreat to his Munich fastness. The eventual accord disappointed many: promises of (necessary) radical reforms were cast aside in favour of (unwarranted) tax increases. Dim memories were awakened of the only previous post-war grand coalition between 1966 and 1969, an undistinguished government under a forgotten chancellor, Kurt Georg Kiesinger.

Yet now, less than 100 days after taking the oath as chancellor, Ms Merkel has touched some unprecedented pinnacles. In a series of foreign forays, she has charmed and won plaudits from Washington to Brussels to Jerusalem. She gave the keynote speech at the Davos World Economic Forum. To cap it all, last weekend a German opinion poll gave her an 80% popularity rating, the highest ever recorded by a chancellor. Her party is united and confident; the SPD is glum and confused, and fears it may lose a March state election in Rhineland-Palatinate, one of its last strongholds. Even Ms Merkel's dowdiness has been swept away by a slick makeover. And, as if by magic, the German economy, once the sickest in Europe, is bouncing back: business confidence is high, exports are breaking records, and even consumers are at last perking up.

Too good to be true

Is it all froth, or is there substance behind the changed perceptions, of both chancellor and country? The chancellor is just over two months into her term, and today's outbreak of Merkel mania is unlikely to last. But on balance there are reasons for cautious optimism about her chancellorship—even if there are also grounds for continuing concern about Germany.

It is in foreign policy that Ms Merkel's impact has been most obvious. Mr Schröder had led Germany up a blind alley, falling out with the Americans over Iraq, unthinkingly supporting the French in the European Union, and cosying up to Russia's Vladimir Putin despite protests from Germany's eastern neighbours. Ms Merkel has decided to be an anti-Schröder—and, in the process, elbowed aside her own (SPD) foreign minister, Frank-Walter Steinmeier, who previously served as Mr Schröder's chief of staff.

At the Brussels summit in December, she no longer lined up behind France's Jacques Chirac but rather acted as intermediary and deal-broker between him and Britain's Tony Blair. In Washington last month, she mended fences with George Bush's administration. In Moscow, she was more critical of Mr Putin's shift to autocracy than Mr Schröder has ever been. And she assured her prickly Polish and other neighbours that she would never overlook their interests.

Sunny abroad, cloudier back home

Last weekend, Ms Merkel underlined the change of tone at the Munich security conference. She stressed the primary role of NATO in European security, and spoke out firmly about the dangers of a nuclear Iran. To the Americans and British, her message was that Germany is once again a reliable partner; to the French and Russians, it was that soft German acquiescence should no longer be taken for granted. To be sure, changed German attitudes will hardly mean a changed world. But since this is Europe's biggest and most important country, it should materially reinforce the West's foreign policy.

The picture is a bit cloudier at home. The revival of the German economy seems genuine enough. To a small extent, it reflects the reforms that Mr Schröder himself pushed through; to a greater one, it reflects the determination of German business and German workers to regain their lost competitiveness. Either way, other laggards in Europe such as France, Italy and the Netherlands will benefit as the biggest European economy picks up steam. With luck too, faster growth in the German economy, and so in tax revenues, may provide an excuse to put off the indirect-tax increases promised by the grand coalition for next year—for the risk is otherwise that a hesitant economic recovery gets knocked on the head.

Yet higher taxes are not the only concern. Although German business looks robust, the country still suffers from many familiar ills (see our survey): an over-regulated labour market, an unreformed public sector (which staged its biggest strikes in 14 years this week), poor schools and universities, and an unresponsive health system. Ms Merkel's willingness to tackle these is in doubt. That is partly because she is hobbled by her coalition partner; if things keep going well for her, she can look forward to a fresh election in two years' time after which she can govern without the SPD, and perhaps emerge as more of a reformer. But it is also because by nature she prefers small methodical steps to giant leaps and bold radicalism. At present, in short, she looks more like another Kohl than like a German version of Margaret Thatcher.

In foreign policy, that may be sufficient to improve her country's standing and weight in the world. But at home the risk remains that she will not do enough to shake Germany out of its torpor. Ms Merkel has begun promisingly. But her biggest tests are still to come.

Taxonomy

Names for sale

Feb 9th 2006
From The Economist print edition

The ancient science of taxonomy might benefit from a little modern marketing

CALLICEBUS AUREIPALATII is a Bolivian monkey whose biggest claim to fame is that its name came by way of an internet auction. It was purchased last year by a Canadian online casino for $650,000; and thus the Golden Palace monkey came into the scientific literature and Bolivian conservationists hit the jackpot.

If that all sounds a bit *infra dig*, the facts of the matter are that millions of animals are in need of names and that taxonomists require all the inspiration they can get. Frequently they name their discoveries after each other, after members of their families and (at least in the days when private patronage financed collecting expeditions) after the rich dilettantes who paid the bills. But that leaves plenty of critters without a moniker, so the net has been cast wider.

Money spiders and gold bugs

Last year, for example, America's president, vice president and defence secretary each got a beetle (*Agathidium bushi*, *A. cheneyi*, *A. rumsfeldi*) courtesy of two Republican coleopterists. Admittedly, the beetles in question eat slime mould, which caused a few titters among taxonomists of a Democrat persuasion, but it is clearly an act of gross speciesism to criticise the dining habits of other organisms, so the titters were *sotto voce*. And it is not only politicians who are benefiting. Sting, a musician, has his own tree frog (*Hyla stingi*), and several spiders also bear the names of entertainers (*Calponia harrisonfordi*, *Pachygnatha zappa*) who clearly have taxonomists as fans.

Which is all well and good, but does not really benefit taxonomy as a science. So *The Economist* would like to suggest that the Bolivians who sold off naming rights to their discovery were on to something.

Notwithstanding recent discoveries in New Guinea (see article) few biologists these days have flashy mammals and birds to hawk around. But a little imagination might find sponsors for lesser creatures. For, while a wealthy airline (if any still exist) might aspire to a Papuan bird of paradise, its low-cost confrere could consider something a bit more within its budget—a butterfly, perhaps? And which building society would not be seriously tempted by its own bee? These humble yet hard-working animals save in the summer to survive through the winter—and build their own homes, to boot. Neglected molluscs could, meanwhile, be snapped up by Shell, while moth taxonomy would certainly be boosted by the interest of the construction-equipment firm, Caterpillar.

Of course this leaves the difficulty of who will sponsor unloved animals such as leeches, worms and dung beetles. The nematodes, in particular, are a vast group of tiny worms that are both ubiquitous and virtually unacknowledged outside the laboratory. There may be executives at Wrigley brave enough to make the leap; though consumers may take the view that the nematodes' brand values are best aligned with those of lawyers' firms.

Detractors of such horrid commercialisation there will no doubt be. But they might consider that taxonomists have been amusing themselves quietly for years, as names such as *Colon rectum* (a beetle), *Ba humbugi* (a snail), *Oedipus complex* (a salamander) and *Ytu brutus* (a beetle) attest. Besides, how much disrepute could commerce really bring to the discipline that brought the world *Trombicula fujigmo*, a mite whose name is an acronym for “fuck you Jack, I got my orders.”

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European economies

Freedom fried

Feb 9th 2006
From The Economist print edition

The four freedoms on which the European Union is based are under threat

TALK about threats to freedom in Europe at the moment, and the images that spring to mind are burning embassies and cowering journalists. But there is another threat to European liberties that is equally current—and has deeper long-term implications for the continent's prosperity. This menace is to the four freedoms that underpin the European Union's internal market: the free movement of goods, labour, capital and services.

The promotion of the four freedoms has increased the prosperity and liberty of ordinary Europeans. But now there is a backlash. More and more politicians are complaining that the EU is pursuing policies that cause economic insecurity. As a result, all four freedoms are now directly threatened.

For most Europeans, free movement of labour is the most practical benefit the EU offers. Unfortunately, at the moment it is also the most restricted. Worried about competition from low-wage labour from central Europe, 12 of the 15 EU countries in western Europe insisted on temporary restrictions on free movement of labour when the central Europeans joined the EU in 2004. This week a report from the European Commission concluded that the three countries that have opened their labour markets—Britain, Ireland and Sweden—have all benefited (see article). But facts seem unlikely to overcome fears. While some more EU countries like Spain may now open up, Germany, Austria and France all seem likely to maintain their restrictions—curbing personal freedom and driving economic activity underground in the process.

The free movement of capital is also under attack. In December France announced that it would protect industries in 11 areas from foreign takeovers. The European Commission seems likely to challenge this apparently flagrant breach of European law. But the French government shows little

sign of backing down. On the contrary, it has reacted with deep hostility to a proposed takeover of Arcelor, a steelmaker that is a big employer in France. The French are not the only backsliders. Germany has fought hard to preserve a law that protects Volkswagen from foreign takeovers. And the new Polish government, which has regrettably protectionist instincts, is challenging an EU-approved cross-border bank takeover.

A moment of truth is also fast approaching for services in Europe. A proposed new law, which the European Parliament will vote on next week, would make it easier for everyone from plumbers to doctors and architects to ply their trade across the EU without falling foul of restrictive local regulations. Sadly, the parliament is likely to insist on far-reaching amendments to the law that may mean it excludes areas such as health, the media, postal services, electricity, water and gas. Hairdressers and personal trainers may be exempt—but at this rate the services directive will be barely worth having. One industry—energy—is already going backwards (see article).

The free movement of goods is the best-established of the four freedoms within Europe. But the EU is in danger of adopting an increasingly protectionist attitude to anything made outside Europe. Despite a recent fiasco over textile imports from China (the infamous bra wars), the commission is under enormous pressure to introduce new “emergency” restraints for other goods, such as shoes.

Fearful times

This new, frightened mood is partly a tribute to the changes that the EU has already fostered—Polish workers (legal or otherwise) are already a presence in much of western Europe; cross-border mergers are growing in number. At a time of high unemployment, changes like these create feelings of insecurity. But there is more to it than that. Many politicians have interpreted the defeat of a proposed EU constitution in referendums in France and the Netherlands last year as a backlash against economic liberalism. In a bid to save their cherished dream of political union in Europe, they have decided that their voters must be placated with more “social Europe”.

Such a scheme is, of course, incoherent. How can you promote political unity in Europe, while simultaneously throwing up nationalist defences against other European firms and workers? How can Europe aspire to be a global force, if it cowers behind protectionist trade walls?

Unfortunately, while the logic may be clear, the political climate is distinctly unpromising. The European Commission, which has done a good job expanding Europe's four freedoms over the past decade, may find that over the next year its most urgent task is to prevent those freedoms being rolled back.

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Dealing with North Korea

Fission worries

Feb 9th 2006
From The Economist print edition

At cross-purposes in the six-party talks

BY ANY measure, North Korea's is a difficult regime to deal with. It hurls insults around the neighbourhood. It builds far-flying missiles—and by its own boast nuclear bombs—to back up its threats. It treats its own people appallingly badly. While Kim Jong Il, current dynast-in-chief, was pampering himself as usual, perhaps 2m (out of some 22m) ordinary North Koreans died of hunger and related illnesses following a famine in the mid-1990s, the result of bad luck turned deadly by decades of crack-pot policies. Late last year Mr Kim kicked out international aid agencies, biting off the hand that was still helping to feed many of his destitute people. He has so far spurned lavish inducements to trade in his bombs at on-again-off-again six-party talks with America, South Korea, Japan, China and Russia. How does he get away with it?

By counterfeiting dollars, yuan, yen and euros is part of the answer. So is trafficking in anything from cigarettes and narcotics to missiles. North Korea is not a failed state taken over by criminals, it is a regime organised to maximise profits from its illicit activities. A link with China's underworld triads has taken its distribution and money laundering network global. Taking unkindly to North Korea's faking of its banknotes, America has lately been cracking down on its dodgy dealings (see article). The squeeze, it hoped, would help North Korea see that it has more to gain from reforming its economy, trading in its missiles and warheads and joining in Asia's rapid growth than from its gangster connections.

China and South Korea aren't helping. China is North Korea's propper-up of last resort and by far its largest trading partner and investor. It dreads the instability on their common border that an economic collapse in North Korea might entail, and is reluctant to lean on Mr Kim over his bomb-making. The talks have dragged fruitlessly on, when they have been on at all (there have been no productive talks since September, and had been none for more than a year previously). Meanwhile the large dollops of food aid that China, and to a lesser extent South Korea, now shovel Mr Kim's way, no strings attached, enabled him to kick out the aid agencies that had tried to check that food went to the needy, not to the army or his cronies.

South Korea insists firmly that North Korea must not have nuclear weapons (glossing over its repeated claims to have several). Yet it wants to coax North Korea out of its nuclear bunker, rather than pressure it. It hopes aid and trade will encourage Mr Kim to adopt economic reforms that will improve the lives of his people. The moral cost to South Korea has been high: keeping mostly silent about North Korea's egregious human-rights abuses, including the abduction of scores of South Korean citizens. And there has been precious little return. The supposed high point of North-South relations, the first ever summit between their two leaders, in 2000, was bought

with a mega-bribe from South Korea.

There are other costs too. Hopes have been dashed that economic changes in the aftermath of the famine, including allowing peasants to sell their produce at private markets, were the harbingers of real change. A better harvest last year and generous hand-outs from the neighbours have allowed Mr Kim to tighten his grip on food distribution once more.

Splitting the atom talks

South Korea has told North Korea that, if it gives up its nuclear weapons, much more generous aid, investment and supplies of energy would quickly be on tap. But that is little incentive for Mr Kim, who has shown scant regard over the years for the welfare of ordinary North Koreans. He calculates that he has enough going for him to stay safely on top.

Though it dislikes America's harsher tactics, South Korea's indulgence of Mr Kim and his tyrannical habits is now undermining its own ends. It is not helping to resolve the nuclear issue. It is not helping to feed those North Koreans who really go hungry. And it is removing the incentive for the kinds of market-opening reforms that could ease their plight.

The aim in getting those with a stake in the North Korea problem around the six-party table was to make it hard for Mr Kim to play one off against the other and so hang on to his bombs and bad habits. He will be pleased at the outcome.

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On corporations, Hamas, the City University of New York, debt, XL Capital, French, drinking, unfunny cartoons, corruption in Africa

Feb 9th 2006
From Economist.com

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Firm observations

SIR – In general I thought your articles on "the new organisation" were superb ("A survey of the company", January 21st). However, I have two reservations. The minor one has to do with my former colleague and mentor, Douglas McGregor. He was not a "Harvard academic" (though he did get his doctorate there). Both his writings and reputation stemmed from his years at MIT's Sloan School.

Second, and more importantly, bureaucracy still thrives and is alive and well. I wrote an article in 1959, ironically published in IBM's in-house magazine, *Think*, titled "The End of Bureaucracy". Yet my colleague Harold Leavitt wrote in his recent book, "Top Down", that hierarchies "are here to stay". Despite our aspirations and writings on behalf of a vivid utopia, the iron law of hierarchy is as adamantine as a flawed diamond.

Warren Bennis
Distinguished professor of business
University of Southern California
Los Angeles

SIR – From a productivity perspective I must quibble with your characterisation of the key role played by the "knowledge mule", who is "someone who carries ideas from one corporate silo to another and thereby sparks off new ideas". This is asking quite a lot from your typical corporate mule. Frankly, I much prefer the image of the knowledge bumblebee who flits from one corporation to another, thereby pollinating each silo with new ideas in the process.

Todd Landau
Summit, New Jersey

Hawks in, doves out

SIR – With Hamas winning the Palestinian election by a landslide, it could be the first time that the Palestinian Authority has had the popular support necessary to carry the peace process forward ("Enter Hamas", January 28th). Although we shouldn't trust this terrorist group, recent history in the region does show that "only hawks can make peace" ("After Sharon", January 7th).

Angel Rivera

Indianapolis, Indiana

A standards argument

SIR – Your article on the City University of New York states that when the institution initiated open admissions after 1969, "the quality of education collapsed" ("Rebuilding the American dream machine", January 21st). This is how the media usually portrays standards at CUNY, even though the evidence suggests otherwise. With respect to CUNY's City College, the focus of your article, the National Research Council reported that between 1983 and 1992, in the heart of the open-admissions era, 860 graduates went on to earn a PhD. This number was higher than that for City College's prestigious neighbour, Columbia (compared with almost all other colleges in the New York area, a higher percentage of City College graduates earned a PhD). To be sure, City College's undergraduate student body was somewhat larger than Columbia's, but the comparison is illuminating.

William Crain
Professor of psychology
The City College, CUNY
New York

Who pays GM's debt?

SIR – Regardless of the reality of the "dark matter" that allegedly raises the value of American-owned foreign assets, imprecise language causes confusion about international commerce (Economics focus, January 21st). Consider the term "American indebtedness". In so far as Uncle Sam is in debt, Americans can fairly be said to owe principal and interest to the government's creditors. But the same isn't true for, say, General Motors' debt. While GM's creditors are owed money by GM's shareholders, the indebtedness of those Americans owning no GM equity isn't the slightest bit raised by GM's debt. And yet any GM debt owed to non-Americans is reckoned to be American indebtedness. Why? An American owning no GM equity is as free from obligations stemming from GM debt as is a Canadian or a Kenyan owning no GM equity—and more free from these obligations than are GM-shareholders in Britain and Belarus.

Donald Boudreaux
Chairman
Department of economics
George Mason University
Fairfax, Virginia

SIR – America's experience of earning positive net-income from negative net-foreign-assets isn't without precedent—Britain was in the same position after the second world war. Then, as in America now, the situation arose from a period in which the country had lived beyond its means but was able to use its financial savvy to ensure higher returns on its assets than it paid on its liabilities. It was symptomatic of its relative economic decline, which is also a precedent for America.

John Odling-Smee
Moreton-in-Marsh, Gloucestershire

Independent directors

SIR – The table accompanying your article on executive pay is confusing ("Book of revelations", January 21st). You have sub-titled the table "Boards' independent directors' total compensation"

and placed XL Capital at the top of the table. This is not accurate. The total compensation paid by XL Capital to its independent directors is lower than that for any of the companies listed in your table. Accordingly, XL Capital should not have appeared in this table.

The New York Stock Exchange requires that listed companies classify their directors as independent or not. As a NYSE-listed company, XL Capital adheres to that requirement by publishing and following standards for determining independence under the NYSE's criteria—being deemed a “non-executive director” is not sufficient to meet the standards of independence and the two terms are not interchangeable.

Moreover, the distinction conferred by independence is not trivial. The Council of Institutional Investors has said that it is in “the corporation's and all shareholders' best financial interest” for companies to promulgate “a narrowly-drawn definition of an independent director”. XL Capital agrees with and abides by this principle.

David Radulski
Senior vice-president, director of investor relations
XL Capital Ltd
Hamilton, Bermuda

The French-language class

SIR – I was flabbergasted to read Michael Marchadier's letter from Montreal stating that “Most French officials speak English and studied in British or American colleges” (January 14th). If only it were so. The political world in France is mainly monolingual and parliamentarians do not travel or work abroad much. Apart from the prime minister, the trilingual Dominique de Villepin, you will have trouble finding any French politician who can speak decent English.

Guy de Dampierre
Paris

Putting the fun into religion

SIR – Please pass my thanks on to Lexington for informing me that drinking is a “Catholic pastime” (January 28th). What a dreadful imposition I must have been making on my non-Catholic friends.

Brian Devlin
Sale, Cheshire

ONLINE ARTICLES

The following correspondence refers to articles published only online

The Satanic sketches

SIR - Why choose to join the “Freedom of Speech” parade and provide links to those tasteless and offensive cartoons ("The Satanic sketches", Economist.com, February 3rd)? Media outlets, in or outside the Muslim world, can very well provide objective reporting without offending their readers’ religious sensitivities. When was the last time Muslim media caricatured Jesus or Moses in a sexual or violent way? Dare we imagine if a cartoonist depicted Jesus throwing bombs, or caricatured the Holocaust?

A. Laidi

SIR - At any cost it should be made clear that free speech is not subject to negotiation and that no insult warrants violence. It would become the Muslim governments who have so ferociously condemned our press freedom if they would at least confine censorship to their own dictatorships.

Christian Andersen

SIR - The motives of those protesting against the publication of cartoons deemed insulting by many Muslims could be very noble. Moreover, they have legitimate grievances that can make intolerance more difficult to bear. However, I am not aware that they protest against the insulting treatment of Jews, Christians and others in the Muslim press with equal vigour, if at all. If they made a more principled and consistent stand against intolerance regardless of its source, it might improve understanding for their concerns and help better present their case.

David Andrews

SIR - There is nothing to reconcile between the rights of some and the sensitivities of others: rights always trump sensitivities. It is not the business of democracies to discourage conflict. There must be unconditional protection of a few basic human rights. One of them is freedom of speech. Denmark's prime minister, Anders Fogh Rasmussen, has no mandate to express his distress to flag-tearing believers in anybody's name but his own. That should stay that way.

Gabi Huiber

SIR - No social system recognises abusive language as a part of the freedom of speech. It is in this context that nations have censorship, through the legal system or self-censorship. Making the Prophet Muhammad the subject of ridicule puts a negative perspective on the entire religion of Islam. It is a poor reflection on newspapers and some European nations. Civilisations have grown by understanding and appreciating other perspectives.

Kanwal Jit Singh

Corruption in Africa

SIR - Your article ("Africa's unending war on corruption", Economist.com, February 3rd) is another sad reminder of our continuing failure in dealing with this chronic social malady. What we need is a different cure. Rich nations attempt to encourage corrupt countries to reduce corruption by using development aid as a carrot or a stick. This approach has been painfully ineffective. We need to re-visit our reasoning. If we think corrupt leaders are stashing away millions in aid for personal gain, do we really believe they are civic-minded enough to give up their lucrative deals in order to increase aid to their countries?

There is a simple and powerful alternative treatment ready to borrow from the market: offer incentives to a country's leaders as we offer incentives to a company's leader. Let a few million dollars in aid be paid to the leader personally for meeting anti-corruption targets. Then watch him begin in earnest to pursue anti-corruption campaigns.

Michael Yaziji

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Islam and free speech

Mutual incomprehension, mutual outrage

Feb 9th 2006 | CAIRO, COPENHAGEN AND PARIS
From The Economist print edition

Reuters

Global protests over cartoons of Muhammad, and the jailing of a Muslim in Britain for inciting murder, reveal once more the gulf between Islam and the West

WHEN, last September, the Danish newspaper *Jyllands-Posten* published a dozen cartoons of the prophet Muhammad, it knew it was testing the limits of free speech and good taste. But it could never have imagined how much. For Denmark itself, this has been the biggest crisis since the Nazi occupation during the second world war. But the implications for the already vexed relations between the West and Islam go far wider. Denmark's prime minister, Anders Fogh Rasmussen, summed it up: “We are today facing a global crisis that has the potential to escalate beyond the control of governments.”

At least ten people have died so far in protests against the cartoons. Several were killed in Afghanistan as police shot into a crowd besieging a Norwegian peacekeepers' base. More were shot dead as they tried to storm an American military base in the south of the country, setting cars alight and hurling rocks.

Western embassies in Syria, Lebanon, Indonesia and Iran have been attacked. Mosque sermons from Senegal to Sumatra have blasted the insult to the faith. Demonstrators in Karachi burned an effigy of the Danish prime minister. In Khartoum, some enraged marchers among a crowd of 50,000 chanted “Strike, strike, bin Laden.” Saudi Arabia, Syria, Libya and Iran have all withdrawn their ambassadors from Denmark. Iran has formally banned imports from Denmark, while consumer boycotts across the Middle East have emptied supermarket shelves of all Danish products.

Western governments have reacted with shock and muddle. There is a growing feeling in continental Europe that Britain and America should have taken a principled stand on grounds of free speech, but have failed. In France, home to Europe's biggest Muslim minority—roughly 10% of the population—there has been surprise at the relatively conciliatory response of Jack Straw, Britain's foreign secretary, who called the publication of the cartoons “insensitive” and “unnecessary”. Many in France are baffled at the reluctance of the British and American press to publish the cartoons themselves. (On February 8th, three editors and a reporter quit the *New York Press* over a decision not to reprint the cartoons, and President George Bush called on world governments to stop the violence and be “respectful”.)

To be sure, the official French reaction has been measured. President Jacques Chirac declared that freedom of expression was “one of the foundations of the republic” but added a plea for “respect and moderation” in its application. And one editor at *France-Soir*, a small newspaper that was the first to claim the “right to caricature God”, was sacked after publishing all 12 caricatures. Yet it seemed that the paper's owner, a Franco-Egyptian, had been seeking an excuse to get rid of him anyway. The rest of the press, along with those who see the matter as a test case of the ability of French democracy to withstand the demands of political Islam, have taken an increasingly muscular position.

Several big national papers, including *Le Monde* and *Libération*, have republished some of the cartoons to make a point about their right to do so. This week they were joined by *Charlie Hebdo*, a satirical weekly—despite a last-minute attempt to secure an injunction against it by several French Muslim organisations. *Charlie Hebdo* reprinted a text from the Manifesto of Liberties Association, a French secular Muslim body, arguing that the orchestrated violence was a warning to Europe's Muslims from abroad that “You don't have the right to think ‘like Europeans’”, and urging the West to reaffirm Europe's tradition of free thought.

That some offence should be taken is understandable. The Muslim injunction against picturing recognised prophets is well known. Yet the point of proscribing images is to ensure that they do not become objects of worship in themselves. Muslims generally shrug indifferently at Christian representations of Jesus or Moses, both of whom Islam also venerates.

In this case, however, the caricaturing of Muhammad was clearly meant as a challenge. Several of the images were frankly insulting, particularly those that pictured the Muslim prophet as a terrorist. It adds to the sense, which has grown among Muslims since America launched its war on terror after September 11th, 2001, that their faith itself is being branded as violent and criminal. In addition, pious Muslims believe that Muhammad, while mortal, is the embodiment of manly perfection; at the same time a prophet, a moral example and a political leader. “He is not a believer”, runs one of the prophet's sayings, “if he does not love me more than his father or son or all people.”

Muslims worldwide have also grown keenly sensitive to what they see as western double standards. Freedom of speech is an admirable thing, says a Syrian member of parliament, but why do European countries forbid questioning of the Holocaust? Why are Muslim preachers jailed for incitement while anti-Muslim slurs go unpunished? And why, as a natural extension of this thought, does the West ignore Israel's atomic arsenal while questioning Iran's nuclear ambitions?

At the same time there is little understanding, in many Muslim countries, either of how Western democracies function, or how they have evolved historically towards enshrining maximum personal freedom. Danish protests that there are no laws empowering the government to intervene are met with disbelief. In both Yemen and Jordan, editors who republished the cartoons (which have now appeared in 22 different countries) were promptly arrested and their newspapers shut down.

Leaders and manipulators

Some protests seem to have been spontaneous; others have been deliberately manipulated by Islamist elements. While demonstrations have been widespread, the number of participants has generally not been large. Moderate leaders, from Iraq's foremost Shia authority, Grand Ayatollah Ali al-Sistani, to Ekmeleddin Ihsanoglu, who heads the Organisation of Islamic Conferences, have called for Muslims to express their feelings peacefully. A *fatwa* issued by Egypt's highly respected grand mufti, Ali Gomaa, states that Muslims should understand that others will attack their faith; and although they should reject this “perverted behaviour”, he said, they should protest peacefully, with “wisdom and fair exhortation”.

This stand presents a clear contrast to the rabble-rousing tactics used by others. A Danish imam, Abu Laban, may have started the whole thing by touring the Middle East to drum up outrage, including distributing far more offensive cartoons of the Prophet (as a pig, as a paedophile) which he said had been “received” by Muslims in Denmark. Iran's supreme guide described the furore as a plot “concocted by Zionists angered by the victory of Hamas in the Palestinian elections”—though the Palestinian vote took place four months after the publication of the cartoons. In Syria, a police state allied to Iran where rioters have torched the Danish and Norwegian embassies, witnesses noted men with walkie-talkies directing the crowds. Security was so ineffectual that camera crews accompanied arsonists into the buildings. In neighbouring Lebanon, authorities say that one-third of the 400 people arrested for setting fire to the Danish embassy and vandalising the surrounding Christian district were Syrians. On February 8th Condoleezza Rice, America's secretary of state, remarked that Iran and Syria had so stirred up the violence for their own ends that “the world ought to call them on it.”

Reuters

Taking it out on Denmark

Some analysts have speculated that the Muslim Brotherhood, a global fraternity of Islamist groups with branches in some 70 countries, may have a hand in the uproar. This is unlikely. The most vigorous Palestinian protests, for example, were led by militants from ostensibly secular Fatah, not Hamas, a Brotherhood offshoot. Protests in other Brotherhood strongholds, such as Egypt, Jordan and Morocco, have been relatively muted. A Brotherhood spokesman in Egypt accused some politicians of playing a “dirty game...to distort the image of the Islamic movement—to get the people to say they are not peaceful, not democratic, against free speech.”

It is more likely that Islamist forces of varying stripes have seized the opportunity both to assert their presence and to reinforce the sense of Muslim embattlement that suits their goals. Recent electoral advances by Islamists, in Turkey, Iraq and Egypt as well as Palestine, had already emboldened these forces. Other competing voices, too, have found the cartoon issue an ideal

platform for promoting their version of the faith. On Egyptian television, one dapper preacher aimed a sermon at the West, urging westerners to love Muhammad; another, his rival for ratings, advised Muslims to dedicate a two-day fast to the victory of their prophet.

Some Muslims find all the hullabaloo distressing. “What it shows is that we lack confidence,” says the headmaster of a Cairo school. “If we were confident about our faith we wouldn't have to react so hysterically.” Many others, however, feel it marks an important precedent. In a Friday sermon at the Grand Mosque in the holy city of Mecca, Saleh bin Humaid, a Saudi preacher, extolled the spirit of defiance that was unifying Muslims. “A great new spirit is flowing through the body of the Islamic nation,” he said. “The world can no longer ignore the nation and its feelings.”

By midweek, moderate Muslims in Denmark, Britain and elsewhere were appealing for calm. Cool-headed leaders, including clerics in Indonesia, the most populous Muslim country, urged restraint. International efforts were also under way to ease tension. A joint statement issued on Tuesday by the United Nations, the Organisation of the Islamic Conferences and the EU condemned violent protests while calling for respect for religion. The EU's foreign-policy supremo, Javier Solana, said he would travel to Arab and Muslim countries to try to calm their anger. He may be gone for some time.

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Racial and religious hatred

Of imams and Nazis

Feb 9th 2006
From The Economist print edition

The Abu Hamza case shows that much has changed in Britain

AFP

Silenced for seven years

ON FEBRUARY 3rd, a crowd of Muslim demonstrators against the cartoons carried placards in front of the Danish embassy in London, urging the faithful to "Butcher those who mock Islam". None was arrested. In the same week, the leader of the far-right British National Party (BNP), who had claimed that Islam was a "vicious, wicked faith", walked free at the end of his trial on charges of inciting racial hatred. But on February 7th, an Arab Muslim cleric was sent down for seven years for inciting racial hatred and soliciting murder at a north London mosque.

The case against Abu Hamza was far more damning than the others. The Egyptian-born former imam of the Finsbury Park mosque had gained notoriety for his fire-and-brimstone preaching against the *Kaffir* (non-believers) and for his links with terrorists. When detectives raided his mosque in January 2003 they found an arsenal of suspect items, including a stun gun, CS spray, chemical warfare-protection suits, blank-firing pistols, false passports, knives and radio equipment.

But it was not until the Americans, describing him as one of the world's most wanted terrorists, asked for his extradition in April 2004 that the British authorities took any action against him. Detained in Belmarsh prison since May 2004, he was charged five months later with 15 offences of inciting murder, stirring up racial hatred and possessing a terrorist document, a ten-volume "Encyclopedia of Afghani Jihad". This explained how to make explosives and organise a terrorist unit, and suggested potential targets for attack that included Big Ben and the Eiffel Tower. Mr Hamza claimed he had never read it.

The jury heard extracts from speeches and sermons in which Mr Hamza, whose real name is Mustafa Kamel Mustafa, railed against adultery, democracy and alcohol, and said that it was part of a Muslim's religious duty to fight in the cause of Allah. "Killing a *Kaffir* for any reason, you can say it is okay, even if there is no reason for it," he asserted. "Islam will never be dear to your hearts unless you sacrifice for it, until your blood comes out for it."

As Peter Clarke, the head of Scotland Yard's anti-terrorist branch, put it, the Finsbury Park mosque was a "honeypot" for extremists. Among the worshippers were Richard Reid, the would-be shoe bomber; Zacarias Moussaoui, the "20th hijacker", who is currently standing trial in Virginia; and Kamel Bourgass, convicted last April of murdering a police officer and plotting to poison Britons with ricin. Others who may yet acquire notoriety slept in the mosque, or bought jihadist books and videos from its basement shop.

Such a honeypot is almost unimaginable today. Trainee terrorists have withdrawn from Britain's mosques, believing them to be too closely watched by the security services. These days, extremists are more likely to assemble in front rooms. They may find inspiration online, and lay plans using internet telephone services.

It is equally improbable that the authorities would now allow a congregation of extremists to fester for so long. The police say that they approached the crown prosecutors more than once and were turned down for lack of enough admissible evidence. (Some had been drawn from wiretaps, not admissible in British courts.) But David Blunkett, then home secretary, claims that the authorities failed to act for fear of provoking Muslim outrage. They also did not consider Mr Hamza a big enough threat. During his trial, Mr Hamza said that he had been approached by agents from MI5, the British security service, who told him that he could say what he wanted, so long as he was not responsible for shedding blood at home. True or not, anti-terrorist prosecutors in other European countries have had a similar impression of Britain's approach to extremism. Until recently, “Londonistan” stood out for its tolerance of inflammatory talk.

Two things have changed in the past few years. The first is that the British police and security services have become much jumpier about the Islamist threat. Even before the atrocities of last July in London, they were coming round to the view that groups of extremists ought to be swiftly broken up, even if there is not enough evidence to charge them with a crime. The consequences of failing to act are simply too grave. If future Abu Hamzas are less likely to be locked up, at least they will be thrown off their stride.

The government has also concluded that hot talk of all kinds is damaging to community relations. Two bills curtailing free speech (one directed at Muslim extremists, the other at those who attack religious groups, including Muslims) have been put before Parliament. And prosecutors have tested older laws.

The right to free speech has always been qualified in Britain. It can be restricted on grounds of national security, prevention of disorder, protection of health and much else. In the BNP case, Nick Griffin, the party leader, and Mark Collett, one of his lieutenants, were accused of stirring up racial hatred in inflammatory speeches at private meetings in West Yorkshire in 2004. In excerpts from undercover recordings Mr Griffin claimed that Muslim gangs were grooming and raping local children, turning white society into a “multiracial hell-hole”. The jury cleared the two men of half the charges against them. The rest will go to a retrial.

In his defence, Mr Griffin had argued that he was attacking a religion, not a race. Although a law against inciting racism already protects religious groups like Jews and Sikhs who also form racial or ethnic minorities, Muslims are not covered. It was to plug this gap that the government introduced its religious hatred bill, under which Mr Griffin might well have been found guilty if it had been passed in its original form. Under it, the “reckless” use of “threatening, insulting or abusive” language would have brought a prosecution. But now such speech is an offence only if “threatening” language is used with the intention of stirring up religious hatred.

As for the cartoons mocking the prophet Muhammad, Britain has an extant, though rarely used, blasphemy law banning defamation of the Christians' God, but not of anyone else's. The cartoons, too, would almost certainly not be caught under the stricter provisions of the amended bill. That does stop people from expressing their fury against them; but inciting people to kill or do harm certainly outrages the law, and is a crime.

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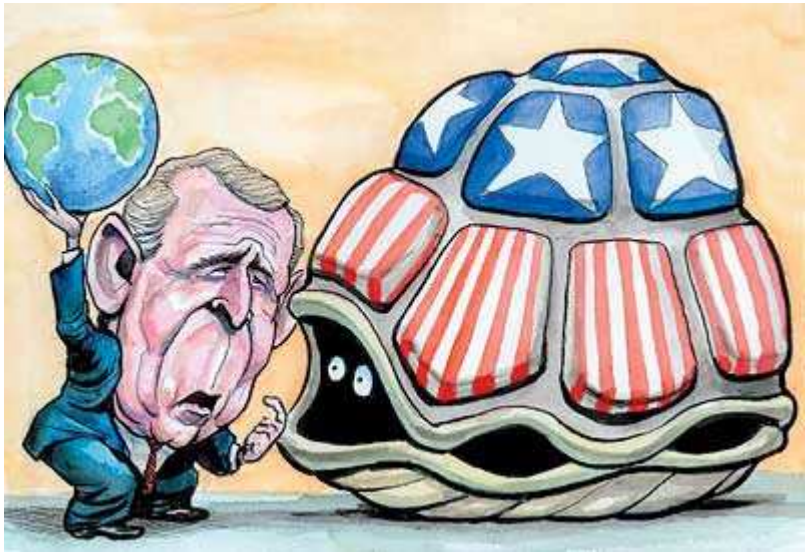
The public mood

The isolationist temptation

Feb 9th 2006 | WASHINGTON, DC
From The Economist print edition



A growing number of Americans would like fewer entanglements with foreigners

FOR many Americans, it's a mad, mad, mad, mad world out there, and getting worse. During the Salman Rushdie affair 17 years ago, angry Muslims were content merely to call for the death of the allegedly blasphemous author and his publishers. This week, they were calling for the death not only of some allegedly blasphemous cartoonists but also their compatriots. And people from neighbouring countries. And Jews. And, inevitably, Americans.

What's the point, some Americans grumble, of engaging with such people? We gave the Iraqis freedom, runs the argument, and they repaid us with roadside bombs. Palestinians got the vote and used it to elect terrorists. And dealing with the rest of the world is scarcely more rewarding: old Europe sneers at us, the Chinese steal our jobs and Mexicans are quietly re-conquering the south-western United States. Wouldn't it be simpler to build a fence around our vast, rich, sane nation and let the rest of the world go hang?

It is a sign of the appeal of such sentiments that George Bush devoted much of his state-of-the-union speech to them.

> “The road of isolationism and protectionism may seem broad and inviting—yet it ends in danger and decline...America rejects the false comfort of isolationism...Isolationism would not only tie our hands in fighting enemies, it would keep us from helping our friends in desperate need...American leaders—from Roosevelt to Truman to Kennedy to Reagan—rejected isolation and retreat, because they knew that America is always

more secure when freedom is on the march."

Mr Bush oversimplified, using one word—isolationist—for several disparate opponents. But he is right to worry. Partly in reaction to the president's hyperactive foreign entanglements, various forms of isolationist sentiment are indeed on the rise. A Pew poll in October found 42% of Americans agreeing that the United States "should mind its own business internationally and let other countries get along the best they can on their own." That figure had jumped by 12 points in three years to its highest level since the mid-1970s (after the humiliation of Vietnam).

Although Mr Bush was hardly fair when he described all advocates of a less muscular foreign policy as "isolationist", he has correctly identified one of the strongest currents against which he must swim. Many Americans wish to disengage from the world in one or more of four ways: by fighting fewer wars, by trading less freely, by allowing fewer foreigners into their country or by giving less foreign aid.

The purest isolationists, ironically, are to be found in the president's own party. Since Mr Bush came to office promising a "humble" foreign policy, they feel betrayed that he has practised the opposite. "Why would a president use his state of the union to lash out at a school of foreign policy thought that has had zero influence in his administration?" fumes Pat Buchanan, a former presidential aspirant and voice of the GOP's nativist wing. The answer: "His foreign policy is visibly failing, and his critics have been proven right."

Iraq never attacked America, argues Mr Buchanan, so America did not have to attack it. As for the idea that America's security depends on ending foreign tyranny, that is "noble-sounding nonsense", writes Mr Buchanan. "Our security rests on US power and will, and not on whether Zimbabwe, Sudan, Syria, Cuba or even China is ruled by tyrants. Our forefathers lived secure in a world of tyrannies by staying out of wars that were none of America's business." Mr Buchanan thinks foreign aid is "the looting of America for the construction of the New World Order". He is proudly protectionist and he fears that Hispanic immigration threatens not only America's survival as one nation but also Republican dominance of American politics, since Latinos usually vote Democrat.

Mr Buchanan has been singing this song for some time: it was part of his pitchfork rebellion against Mr Bush's father in the Republican primaries in 1992. But in damning the Iraq war and the use of force to spread democracy, Mr Buchanan is part of a much broader (and potentially more potent) movement.

On the right, there are two main groups: small-government conservatives and foreign-policy realists. The former point to the huge cost to the taxpayer of the Iraq war and the Pentagon (see article). The latter, typified by Brent Scowcroft, the first President Bush's national-security adviser, think that the old policy of propping up Arab strongmen brought "50 years of peace" to the Middle East.

For different reasons, almost everyone on the left opposes the war. The people who have enough spare time to go on marches and listen to Cindy Sheehan tend to think "BusHitler" invaded Iraq to enrich Halliburton. A larger, quieter group thinks the administration launched an avoidable war and botched it. Overall, the proportion of Americans who think the Iraq war worth fighting has fallen from 70% in April 2003 to about 45% now.

They take our jobs

Opposition to Mr Bush's trade policies comes mostly from the Democrats. The Central American Free Trade Agreement (CAFTA) squeaked through the House last year by 217 votes to 215. Only

15 Democrats backed it—and unions promptly vowed to punish the “CAFTA 15”.

Democratic presidents are usually more supportive of free trade than their party, perhaps because a president represents the whole nation, not just a district with a steel mill that might close because of imports. Hillary Clinton, the Democratic frontrunner for 2008, is a free trader. But it is not impossible that the party's increasingly angry base could nominate a protectionist in 2008. The party's vice-presidential candidate in 2004, Senator John Edwards, voted against cheap textile imports and then made stump speeches about a 10-year-old American girl who, he said, couldn't afford a winter coat. According to Gallup, the proportion of Americans who see foreign trade more as an opportunity for growth than as a threat to the domestic economy fell from 56% in 2000 to 45% last year.

While many Democrats want to curb the inflow of foreign goods, many Republicans want to curb that of foreigners. Mr Bush says the American economy “could not function without” immigrants. Tom Tancredo, a Republican congressman from Colorado, disagrees. He argues that the costs of immigration outweigh the benefits: immigrants' children must be schooled at taxpayers' expense, and their willingness to work for a pittance drags down the wages of unskilled Americans.

He thinks that America's borders could be secured “relatively easily” and at “minimal cost” by building hundreds of miles of fences and deploying troops to patrol them (which would be good training, he says), and by punishing firms that employ illegals. He thinks the House would back 50-60% of his agenda—a tough anti-immigration bill passed late last year and is now in the Senate—and he hopes to make immigration an issue in the November mid-term elections.

It will be. Many non-Hispanic Americans see illegal immigration as not merely an economic threat, but also a cultural one. In a recent poll, only 8% of respondents thought the problem “not very serious”, while 63% thought it “very” or “extremely” serious. The final “isolationist” issue, foreign aid, is not yet electorally significant, though polls show Americans tend to think their country is too generous.

One reason to ignore the growth in isolationism in the short term is Mr Bush. He has made it clear he has no plans to change course. Iraq will be his legacy, so he has to see it through as best he can. He has compromised on free trade before, and may do so again, but few doubt where his preferences lie. On immigration, he seems sincerely liberal and convinced that Republicans can woo the swelling Hispanic vote. And on foreign aid, who'll notice a few odd billions in a budget of $2.77 trillion?

Optimists point out that America has always had a vocal isolationist minority. And surely globalisation—more travel, ever deeper economic integration, common threats (such as global warming and terrorism)—mean that America cannot go it alone. Francis Fukuyama, a famously optimistic professor at Johns Hopkins University, even thinks the Muhammad cartoon row could pull America and Europe closer together, as Europeans realise they have more in common even with Texans than with Islamists.

So the most likely outcome is surely that the current isolationist surge will fade away. But consider two things. First, greater integration and the war on terror have hardly brought the two sides of the Atlantic together. Meanwhile, despite his proud words in the state of the union, isolationism, broadly defined, has already tempered Mr Bush's policy. The public's exhaustion with Iraq makes it harder for the president to tackle Iran. He will also have to retreat on immigration if he is going to get something through.

A lot depends on leadership. For the moment none of the leading candidates for the presidency in 2008 is an isolationist and the favourite in some polls, John McCain, is even more of an interventionist than Mr Bush. But with so many voters angry about the mad world beyond their

borders, America might yet end up with both a more protectionist Congress and a president who is more reluctant to throw America's weight around.

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Christianity and Islam

Hail to the king

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An unusual alliance in the making

AP

Evangelistic in the best sense?

IF ISLAM and monarchy have an acceptable face to the American republic, it is King Abdullah of Jordan. Against the background of pundits worrying about a clash of civilisations, the descendant of the Prophet Muhammad has spent much of the past week schmoozing evangelical Christians.

The king's visit included a starring role at the annual National Prayer Breakfast in Washington, DC. He also preached Islam's virtues at “Ole Miss” university in Oxford, Mississippi, before taking his charm offensive to the White House and the most important born-again Christian of them all.

The king did his best to accentuate the positive in relations between Abraham's quarrelsome children. After deploring the destruction of Christian churches in Iraq—“breaking with a 1,400-year-old tradition of Christian-Muslim friendship”, as he put it, a tad optimistically—he briefed luminaries of the religious right on his efforts to develop Christian pilgrimage sites and look after Jordanian Christians. It went down well. “We are saying to King Abdullah, we support you, we pray for you, we can learn a lot from you,” says Richard Cizik, a vice-president of the National Association of Evangelicals. “Both our religions are evangelistic in the best sense.”

A more tendentious area of common interest between Muslim Jordan and Christian America is a distrust of secular Europe. In public, there was total accord with the visiting king on the issue of the cartoons: the press should be free but responsible. In private, the royal visitors had another well-crafted message: European politicians who backed the cartoonists were fuelling populist Islamophobia. In the words of one royal adviser: “It's sleazy and dangerous for politicians to be scoring points against Islam in a continent where Bosnian Muslims were being put in concentration camps until America intervened.”

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The Quadrennial Defence Review

Rummy's wish list

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From The Economist print edition

AP

Scramble. There's an accountant coming

America's forces are well-organised, well-equipped and too expensive

DONALD RUMSFELD could scarcely have produced a more comprehensive Quadrennial Defence Review (QDR) than the one presented to Congress on February 6th. It also shows the degree to which Iraq has forced the old curmudgeon to change his views of the world.

The QDR predicts threats to America over the next two decades, and lists the things the Defence Department wants to counter them. Like its predecessors, it continues to wrestle with the challenge of using technology to “transform” America's armed forces. But it is the first QDR that takes account fully of the post-September 11th world. (Its immediate predecessor, issued just days after the terrorist attacks, included plenty of analysis but fewer cures.) It is also the first to be drafted—over ten months, by 500 Pentagon employees—with America at war, and it shows.

Terrorists, it says, are the main threat. Others include rogue, possibly nuclear, nations (like North Korea), a mightily-armed rival (ie, China) and the prospect of more natural disasters. America must be ready to face these dangers at once. That could mean waging two simultaneous wars (of varying degrees of intensity) while deterring terrorist attacks in other theatres and coping with a natural disaster at home.

Many of its recommendations are based on lessons painfully learned in Iraq and Afghanistan. Most of them aim to improve America's irregular war-fighting, including counter-terrorism and counter-insurgency. The review advocates, for example, a 15% increase in special operations forces (SOF), which follows an 81% increase in their budget between 2001 and 2006. It also wants better human intelligence, more unmanned aerial vehicles and boats for patrolling inland waterways.

Irregular warfare also means some eating of crow on Mr Rumsfeld's part. The QDR stresses the

need for stabilisation operations, or peacekeeping; and to improve America's somewhat limited proficiency at this art, the QDR wants to increase by a third the number of psychological-warfare and civic-affairs specialists. It issues a plea for “considerably improved language and cultural awareness”—a phrase Mr Rumsfeld would have gagged at not long ago. And it even stresses the need for the old bruiser's department to work with other agencies and foreign allies.

Some of this new soft focus can also be spotted when it comes to counter-proliferation. Once again, America needs better co-operation with allies to see off rogue states and terrorists. But there are also plenty of demands for more kit.

The Pentagon wants to build up a team of SOF to track illegal weapons shipments, assisted by new sensors to detect fissile material at long distance. Lest they fail, America needs a broader range of deterrents. The QDR suggests, among other things, converting ballistic nuclear missiles into precision-guided conventional weapons within two years. With these, America could launch long-range strikes to obliterate regimes but not nations.

The review gives equal prominence to China, the power with “greatest potential to compete militarily” with America. It stresses the desire for good relations with the regime but complains that China's rapid increase in defence spending has already upset the balance in Asia. To respond, the QDR wants the navy to double its procurement rate of attack submarines, to two a year, and the air force to build a new long-range bomber.

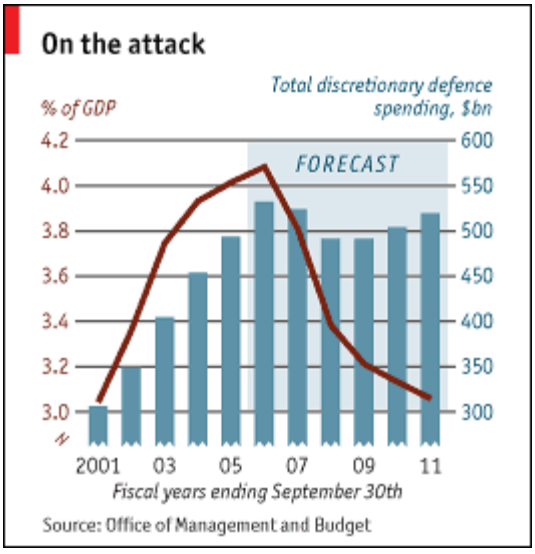
Previous QDRs have been criticised for coming up with somewhat vague transforming plans while failing to make the savings necessary to pay for them. Having, for the first time, matched the QDR's release-date with that of the budget and having constantly stressed his personal commitment to transformation—seldom acknowledging the start made by his predecessors—Mr Rumsfeld was expected to be more decisive.

In fact, there are few dramatic changes. “The QDR is not supposed to do something completely new, it's about shifting the emphasis,” says Mr Rumsfeld. “If you look at SOF, we increased spending in 2002 and since then, and now we're increasing it some more.” The list of such ongoing changes, almost all of them accelerated or initiated by the wars on terror and in Iraq, includes new bits of kit (such as Stryker combat vehicles), a reorganisation of the army into more capable “modular” brigades and a vast base realignment.

Under Mr Rumsfeld, America's armed forces have become far more intelligent, agile and capable; then again, so they should have done. Mr Rumsfeld inherited lots of good ideas, has had a major war to learn from, and is the most powerful defence secretary in recent history. This week he requested a budget of $439.3 billion, representing a 40% increase since 2001; total spending, including the wars in Iraq and Afghanistan, has risen from $306 billion to $524 billion (see chart).

The QDR notably fails to suggest axing any big programmes. The department's only big saving—of around $15 billion—is in personnel. The air force will shed 40,000, the navy 35,000 and the army will lose a temporary increase of 30,000 troops to fight in Iraq. Given that America is already sorely undermanned in Iraq, the proposed cuts will cause a stink. The Pentagon claims they won't hurt its fighting capacity, but the suspicion remains that the generals will always cut troop numbers to hang on to their shiny new programmes. “It's business as usual, kicking the can down the alley,” says a Republican senator. “We've got too many fighter planes, too many ships. If you're going to spend more on fighting

terrorism you also have to make cuts.”



It is not as if there were no candidates for the knife. America has 48 main programmes; all are struggling with time, cost and performance. The navy's DDX destroyer, for instance, will be a spiffing land-attack vessel; but half a dozen of them would cost some $15 billion and they would be crude weapons in irregular warfare. Strategists have similar doubts about the army's future combat system (FCS), a $150 billion attempt to produce a linked family of manned and unmanned weapons, and the air force's F/A-22 fighter (a mere $61.3 billion).

Trying to guess which weapons will be most useful in ten or 20 years' time is a difficult business, with plenty of examples of failures down the ages. All the same, Anthony Cordesman, of the Centre for Strategic and International Studies, is unimpressed by the defence secretary's lack of brutality: “Donald Rumsfeld is at the end of his career. This was his last opportunity to make change, to be substantive, and we end up with a letter to Santa Claus.”

In its preface the QDR claims not to be “a programmatic or budget document”, but a strategic one. It would save a lot of trouble if it could be all three.

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The budget

Penny wise, pound foolish

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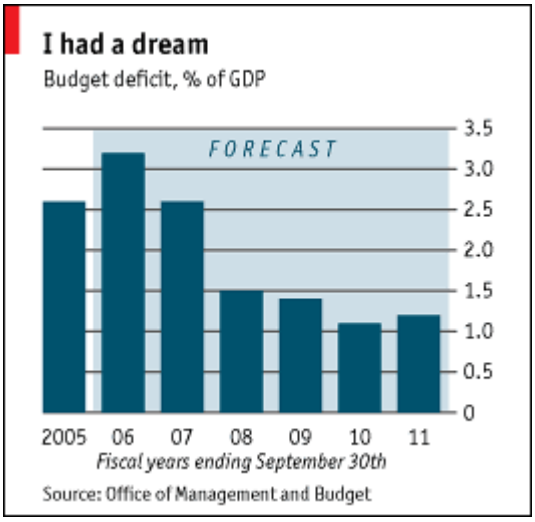
From tax cuts, guns and butter to just tax cuts and guns; now that's progress

GLANCE at George Bush's new budget, released on February 6th, and you might believe this administration really cared about fiscal prudence. The three-page overview has more than 20 references to spending restraint or deficit cutting. The president brags about having kept the growth of discretionary spending (the 40% of the budget that Congress must appropriate every year) below the rate of inflation last year and pledges to do so again. Outside defence and homeland security, 141 programmes are being cut. By 2009, Mr Bush promises, the budget deficit will be down to 1.4% of GDP (see chart).



Look closely, however, and Mr Bush's priorities are rather less frugal. Not only are his spending cuts selective; his concern for tax cuts once again trumps any fealty to budget discipline.

The squeeze on domestic appropriations outside defence is tough, unrealistically so. Mr Bush's budget expects this type of spending to be $35 billion or 7% lower in 2011 than today, despite inflation and population growth. That kind of squeeze, on everything from community policing to help with child care for poor families, is unprecedented. Yet even if it were achieved, the impact on America's overall fiscal health would be small.

That is partly because so much money is being spent on defence (see article). More importantly, domestic discretionary spending only accounts for a sixth of the budget: it is simply too small to be the source of serious savings. According to a new analysis from the Brookings Institution, increases in this type of spending account for only 10% of the deterioration in America's fiscal health since 2000.

Improving the country's long-term fiscal health requires tackling mandatory spending, those public programmes whose costs rise automatically unless Congress intervenes, particularly Medicare and Medicaid, the health plans for the old and poor respectively. The last budget bill, only just passed by Congress, included $40 billion of cuts in mandatory spending, the first such cuts in almost a decade and mostly aimed at Medicaid.

To his credit, Mr Bush is taking a swipe at this behemoth, cutting mandatory spending by $65 billion over the next five years. The largest chunk this time would come from Medicare. Richer retirees, in particular, would have to make higher co-payments for their health care. Mr Bush also has some sensible procedural ideas for stemming Medicare's longer-term cost growth. This is no

radical overhaul of America's most expensive entitlement, but at least it is a start.

Two things, however, mean this may not come to very much. First, it is not clear that Congress will have the stomach for such cuts in an election year. And, second, Mr Bush's modest proposals for trimming entitlements are far outweighed by his obsession with tax cuts.

Not only does this budget propose making permanent all of Mr Bush's previous tax cuts that currently expire between 2008 and 2010; it suggests new ones, particularly an expansion of health-saving accounts. Mr Bush's idea is to promote the use of health-insurance policies with high deductibles (the idea being that if patients have to pay more, they will be more frugal). But the current incentives look like another big tax break for the affluent—and they will cost $52 billion over five years and almost $140 billion over ten.

Add in the cost of making existing tax cuts permanent, and the budget estimates that revenues would be $1.7 trillion lower over the next decade than under current law. Even that is an understatement, thanks to the rise of the Alternative Minimum Tax, a parallel tax that is ensnaring ever more Americans and, in effect, reducing the impact of the Bush tax cuts. Congress has limited the reach of the AMT with short-term fixes. The budget assumes such a fix only for 2007, when everybody knows it will continue thereafter.

In his first term Mr Bush doled out tax cuts as well as “guns and butter”. Now the extravagance is limited to tax cuts and guns. The modest cuts to entitlements are sensible, but when a budget reduces revenues on this scale, it is hard to take the claims of fiscal discipline seriously.

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After September 11th

The hidden killer

Feb 9th 2006 | NEW YORK
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Many of the terrorists' victims have not stopped coughing

Reuters

Hope you kept running

TWO days after the World Trade Centre's towers collapsed in September 2001, Christine Todd Whitman, then the boss of America's Environmental Protection Agency, announced that “EPA is greatly relieved to have learned that there appears to be no significant level of asbestos dust in the air in New York City.” The city heaved a collective sigh of relief—but it has been coughing ever since.

On February 2nd, Deborah Batts, a Manhattan federal judge, blasted Ms Whitman and her agency for repeatedly and knowingly misleading the public into believing the air was safe in the days after the attacks. The collapsing towers released a cloud of hazardous substances, including fibreglass, Freon, mercury, lead, 130,000 gallons of transformer oil and some 2,000 tons of asbestos.

By the next day the EPA already knew that tested air samples contained asbestos levels four times higher than its own danger threshold. Separate studies conducted by other government agencies and independent researchers all found frightening levels of asbestos in homes and workplaces. Yet the EPA and Ms Whitman (a former New Jersey governor), encouraged thousands of New Yorkers to return to their schools, homes and offices.

The EPA, federally mandated to clean up the insides of buildings, passed that responsibility to the still reeling and ill-equipped city of New York. The methods used by the city, though inadequate, were endorsed by the EPA. The agency meanwhile used the latest technology to clean, very thoroughly, its own downtown building. Four and a half years later, Lower Manhattan has yet to be cleaned properly. Even the EPA's internal watchdog criticised the response in 2003.

Judge Batts makes these points in an 83-page pre-trial opinion for a class-action lawsuit filed by students, workers and residents of Lower Manhattan and Brooklyn who say they were exposed to hazardous materials and polluted air. The judge, who described Ms Whitman's assurances as “conscience-shocking”, ruled that she was not entitled to immunity just because she was a public official.

Ms Whitman and the EPA are appealing that decision. It would allow the plaintiffs to continue their suit and to seek monetary damages. Their lead lawyer, Sherrie Savett, says the class-action suit hopes to achieve a proper cleaning for Lower Manhattan, the setting up of a medical monitoring fund and damages for those suffering.

Whatever the merits of the suit, there is plenty of evidence of continuing pain. Babies born after the attacks had significantly shorter gestations and smaller head circumferences, and were underweight. Thousands of New Yorkers are battling respiratory problems, and such diseases may take years to reveal themselves.

Interestingly, on the same day that Judge Batts issued her opinion, a ruling on a similar case filed by firefighters and soldiers went in Ms Whitman's favour. A judge ruled that rescue and clean-up workers were not entitled to sue, in part because the EPA and Ms Whitman made a distinction between risks to workers at Ground Zero and the risks to everyone else. Scores of rescue workers have developed respiratory illnesses and cancer, and the deaths of two emergency response workers and a police detective have been blamed on breathing problems related to the many hours they spent searching for victims.

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The Great Plains

Turning off the taps

Feb 9th 2006
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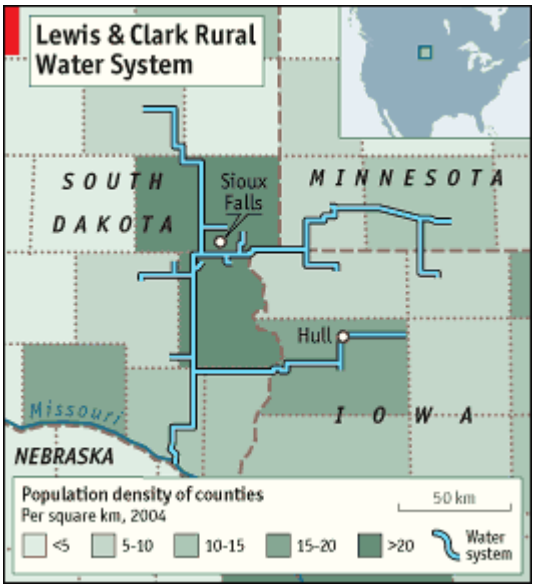
Amid all the other problems a growing need for new pipelines



THERE was a time when clean, sweet water bubbled up from wells in Hull. But like other Iowan towns, Hull's shallow aquifers left its water supply vulnerable to contamination. Pesticides and fertiliser leaked from local farms, raising sulphate levels in the well water and wreaking havoc on newcomers' digestive systems. Ten years ago, Hull capped its wells and turned to its neighbours for clean water. Now a boom in cattle and pig operations has stretched that supply to the limits. Without a new source of clean water, the town's future prosperity is doubtful.

Hull may be a harbinger of a drier future on the northern Plains. The town is one of many in the area whose groundwater has been contaminated by farm chemicals. Hull is one of 15 towns and five rural water systems, including South Dakota's biggest city, Sioux Falls, that have hitched their futures to the Lewis and Clark Rural Water System (LCRWS), a big new pipeline, which in theory will pump 45m gallons a day from the Missouri river to about 200,000 people thinly spread out across South Dakota, Minnesota and Iowa.

Dennis Healy, the boss of the Lincoln-Pipestone Rural Water System in south-western Minnesota, calls the LCRWS, which is due to open in 2018, “our only viable option for a future water source”. The towns and water systems that will benefit from the LCRWS have agreed to bear 10% of the project's estimated $420m price tag, and Sioux Falls has agreed to pay even more. But much of the rest is supposed to come from the federal government. Getting the cash is a priority for the region's senators.

For most of the last century the federal government was eager to help farmers turn the semi-arid northern plains into arable farmland. But that support has waned, along with the rural population. Minnesota, Iowa, North and South Dakota already receive almost $3 billion in agricultural subsidies. Last year, Congress rather grumpily agreed to hand over half the $35m the LCRWS's backers wanted. This year, George Bush's budget offers $21m—$6m more than the project got last year but well below the requested $53m.

Without full funding, completion will be delayed several years, leaving many towns high and dry. Last year, Sioux Falls nearly tripled its requested stake in the project, from 10m gallons a day to 27m gallons. The city grew by 20% between 1990 and 2000. But city officials say water shortages may crimp growth as soon as 2012.

The story is much the same in the northern Plains states. North Dakota is revisiting a huge, 40-year-old project called the Garrison Diversion to deal with water shortages in the Red River Valley. The LCRWS is one of 13 water projects proposed or under development in the northern plains that seek federal money to redistribute water.

But is the answer really to lay new pipes? Natural-resource experts point out that cheap subsidised water has spurred people (and farmers in particular) to overuse it. Tom Power, an economist at the University of Montana, says projects like the LCRWS are “nuts. The last thing you want is federal subsidies for the consumption of resources, especially given the [water] scarcity we face across the West.”

From this perspective, the long-term future is not more federal money, but less, to force farmers to start trading water with the towns. Those creaking pipes may yet be the beginning of a water revolution.

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Lexington

The spirit of '94

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From The Economist print edition

Republican complacency could allow another revolution—but only if the Democrats wake up

FOR the Democrats, 1994 has been a symbol of shame. It was the year in which the Republicans made unprecedented gains—52 seats in the House as well as eight in the Senate—and thereby ended 40 years of Democratic control of the people's chamber. But now 1994 is becoming a symbol of something rather different for them—hope. If a political earthquake can toss our lot out of office, liberals tell themselves, then another political earthquake can do exactly the same to their lot, the power and perks of office notwithstanding.

There are plenty of good reasons for thinking that 2006 could become another 1994. In a remarkably short period today's Republican establishment has lumbered itself with exactly the same problems as yesterday's Democratic establishment—and then some. The Republican Party may not be quite as lethargic as the Democrats were, but it is undoubtedly more corrupt and probably more schizophrenic about policy—first over-reaching with tax cuts and then retreating into tinkering. Polls show that the Republicans are increasingly toxic to voters (they trail their rivals by a stable eight points in generic congressional battles), but they are just as complacent as the Democrats were in 1994—convinced they have jobs for life as long as they are not caught in bed with the proverbial dead girl or live boy.

The Democrats are doing their best to exploit this. Ever since Jack Abramoff, a conservative überlobbyist, pleaded guilty to corruption charges in January, they have hammered away at the “culture of corruption” and tried to show how Washington sleaze hurts ordinary people, forcing them to pay more for energy or spend hours trying to get needlessly complicated drug

prescriptions. (Their best line so far: “The poison tree of corruption” is producing the “fruits of bad legislation”.) But two big differences separate the Republican class of '94 and the Democratic class of '06: differences that could well reduce a regime-changing earthquake into a mild tremor.

The first difference is that in 1994 the out party was united on the most important issues of the day. To a man, Newt Gingrich's Republicans rallied to the idea of shrinking government—a call to arms that rang just about every conservative bell imaginable, from cutting taxes to balancing the budget, from axing welfare to generally getting the government off people's backs. This year the Democrats are all over the place, especially on Iraq. John Murtha wants to get the troops out as quickly as possible; Joe Lieberman wants to send in more troops; and John Kerry wants a phased withdrawal.

The second difference is that 12 years ago the out party enjoyed vigorous leadership. Mr Gingrich started to plan for the Republican majority from the moment that he arrived in Congress. He worked relentlessly on two parallel goals—discrediting the Democrats and refashioning his own party. He worked equally energetically to establish a coherent conservative message—fusing Ronald Reagan's optimism with anti-Clinton populism. And he surrounded himself with a generation of take-no-prisoners activists. In 1994, he marched into battle against the Democratic aristocracy at the head of a new model army of anti-tax people and gun enthusiasts, religious conservatives and home-schoolers, anti-abortion campaigners and small business people.

The current House minority leader, Nancy Pelosi, is about as un-Newtlike as you can get. She has done nothing to galvanise liberal thinking (“Our Democratic message is one of renewing America's promise,” she warbled in her pre-buttal to George Bush's state-of-the-union speech), nothing to shake up the party's senescent establishment and nothing to create a sense that the Democrats are the party of the future. To be fair to Ms Pelosi, she is hardly the only one at fault. But the Democrats' divisions over everything from class to religion paralyse or poison all the things they are trying to do.

The Democrats have failed to prevent Mr Bush from putting two conservatives on the Supreme Court. They have failed to produce even a hint of policy papers. They have failed to thrash out a workable compromise on Iraq (Ms Pelosi says that the party has no collective position on the subject). And they cannot stop infighting: witness the sniping of liberal bloggers at Tim Kaine, the newly-elected governor of Virginia and the party's choice to rebut Mr Bush's state-of-the-union speech, for everything from his religiosity to his opposition to gay marriage to his hyperactive eyebrows.

Elephants on the precipice

Which is not to say that the Republicans can rest easy. Even if there is nobody to push them over the edge, they are still dancing on the edge of a precipice. Look at the way they are congratulating themselves for rejecting Roy Blunt as majority leader in favour of John Boehner, on the basis that he was marginally less friendly towards lobbyists than his rival (the new “clean broom” took a mere $32,000 from Mr Abramoff's clients and rents his flat from a lobbyist). And look at the way the Republicans' main defence on sleaze is that of every politician-on-the-take throughout history: that some of their opponents have been doing it too.

If the Democrats can raise themselves from their stupor, politics could change dramatically. The more Republicans are identified with sleaze, the more their claim to be the party of small government is discredited (and conservative voters stay at home). A Democratic victory in November could usher in an era of bruising confrontation; congressional watchdogs that have been asleep since 2000 would wake up and begin to snarl; every committee would find something to investigate; and impeachment of the president might be transformed from a far-left fantasy

into a real possibility. None of this would make Washington, DC, a particularly pleasant place. But it would allow the Democrats to get the revenge they so keenly desire.

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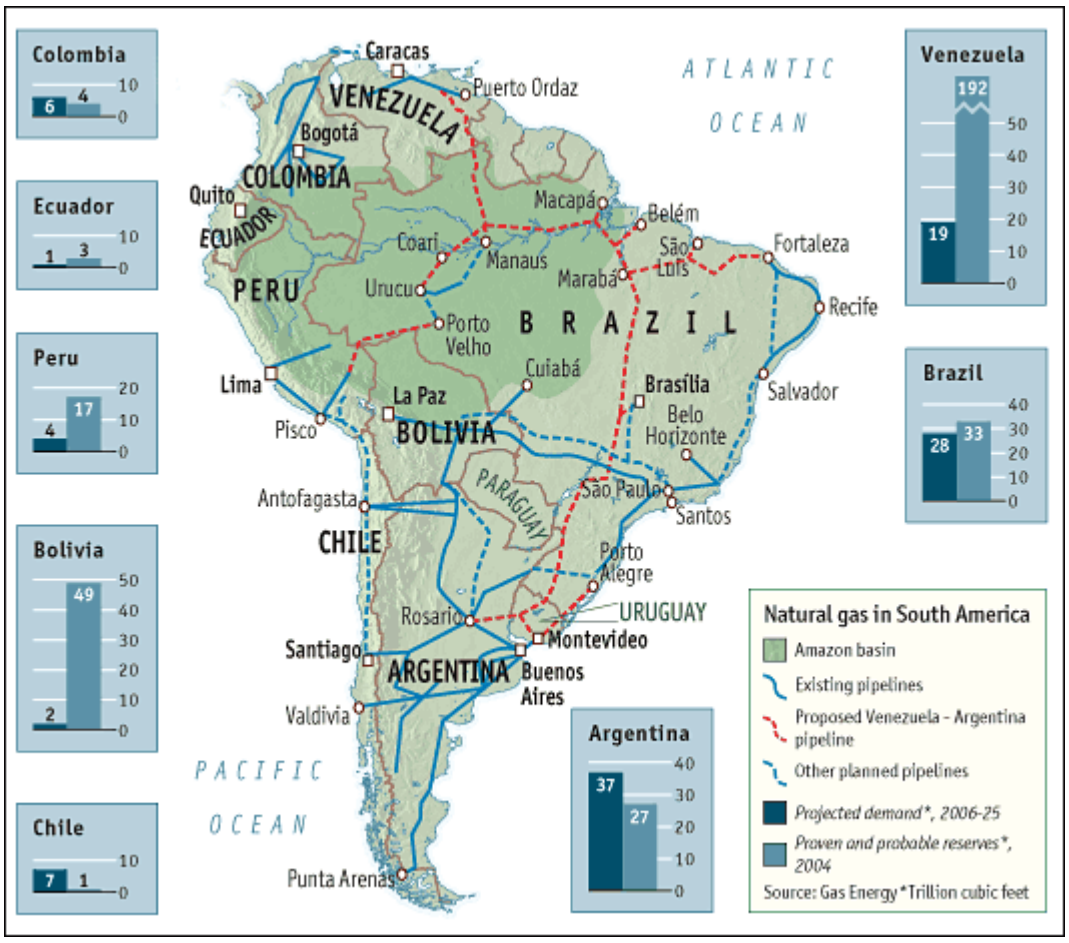
Energy in South America

The explosive nature of gas

Feb 9th 2006 | SÃO PAULO AND CARACAS
From The Economist print edition



Getting energy integration right could be a huge economic boon. Political passions have put that prospect at risk

GLANCE at our map of natural gas supply and demand in South America, and at first sight the "Great Pipeline of the South" promoted by Venezuela's president, Hugo Chávez, seems to make perfect sense. This 8,000km (5,000 mile) duct to Buenos Aires, slicing through the Amazon rainforest, would deliver 150m cubic metres a day of Venezuela's vast, but little-developed, gas reserves to energy-short consumers in the southern cone. Last month, Brazil's president, Luiz Inácio Lula da Silva, and his Argentine counterpart, Néstor Kirchner, agreed to study the project.

Yet look more closely, and this $20 billion project sums up all that is wrong with South America's approach to natural gas. It makes no economic sense: beyond 3,000km, it is cheaper to liquefy

and ship natural gas than pipe it. The environmental costs are troubling. For consumers, Russia's recent disruption of gas exports to Ukraine highlighted the perils of pipeline dependence. The motives of Mr Chávez are purely political: he would love to deprive the United States of gas in the name of South American integration.

Fortunately, the pipeline looks like a pipedream. It is only the most egregious example of the way in which gas has provoked more passion than sense in South America. The region is blessed with an abundance of gas. But the biggest reserves are in countries whose governments are least inclined to treat it like an ordinary commodity. “Shortages amid plenty are the underlying irony of it all,” says Jed Bailey of Cambridge Energy Research Associates, a consultancy in Massachusetts. Mating producers with consumers would be a boon to both. It would also be a welcome sign that the region's leftward drift is not a flight from economic reality.

The problems began in Argentina and Bolivia, two of the three biggest producers. In 2002, Argentina converted gas tariffs from dollars to devalued pesos and froze them. The price of gas, which accounts for half of Argentina's energy consumption, plunged by two-thirds. As the economy recovered from financial collapse, demand boomed. Supply—unsurprisingly—did not keep pace. Deterred by low prices, energy companies stopped exploring. Argentina's proven gas reserves fell by 35% between 2000 and 2004. Facing winter shortages, the government cut exports to Chile.

Mr Kirchner has now allowed prices for large consumers to rise to international market levels. But residential prices remain frozen, and the investment climate remains unpredictable. Enarsa, a new state firm, has signed deals with Brazil's Petrobras and Spain's Repsol for offshore exploration. But at current prices there is little incentive for offshore production, says Luciano Gremone of Standard & Poor's, a credit-rating agency.

To ease its self-inflicted shortage, Argentina looks to Bolivia. That poor and landlocked country is the region's energy hope—and headache. Its gas reserves rank second only to those of Venezuela. It already exports around 30m cubic metres a day, mainly to Brazil but also to Argentina. With more investment, it could quickly double those exports, and add more to gas-hungry Chile. While Argentina will need seven years to develop fresh supplies, a second pipeline from Bolivia could be built in four, according to Marco Aurélio Tavares of Gas Energy, a consultancy. For Brazil, too, Bolivian gas “is the ideal solution”, says a manager at an energy firm.

That is what foreign companies—Petrobras, Repsol, France's Total, and British Gas—were counting on when they invested $4.9 billion in Bolivia between 1997 and 2004. They were not prepared for the political backlash. Radical movements denounced Bolivia's leaders for handing its natural patrimony to predatory foreigners. A plan to ship liquefied natural gas (LNG) to Mexico and the United States via Chile had roughly the same effect as cartoons of the Prophet Muhammad in the Middle East: not a molecule of Bolivian gas would pass through Chile until it surrendered the coastline it stole in a 19th century war, shouted demonstrators who blocked roads for weeks on end, toppling two presidents and demanding nationalisation.

In December, the gas warriors won power, with the election as president with a clear mandate of Evo Morales, one of their leaders. The next few months may thus define South America's energy picture for years ahead.

The energy companies in Bolivia are already operating under conditions which they consider barely tolerable. A law approved last year under public pressure raised royalties, almost doubling the government's take from gas. That allowed it to begin paying civil servants' wages on time while cutting the fiscal deficit. But the law tore up the terms on which the companies had invested. They are enclosing protest letters with every cheque.

Mr Morales has a historic opportunity to use Bolivia's gas to overcome the country's backwardness. But that depends on two ambitious deals. The first might be an agreement to supply Chile with gas in return for Bolivian access to the sea. Chile's president, Ricardo Lagos, attended Mr Morales's inauguration. Mr Morales will be on hand when Michelle Bachelet is sworn in next month as Mr Lagos's successor.

Second, there is scope for a deal with the multinationals. Mr Morales has made soothing noises, promising “nationalisation” without expropriation. He has invited the companies to become “partners” of YPFB, the revived state oil firm. If that means surrendering both their gas and the right to set export prices, the firms will want compensation and/or big tax breaks on future investment. The main hope for compromise is that rupture could be worse for both sides. The companies would be forced to write off their investments. The government could seek deals with state oil companies in Venezuela and elsewhere but would face lawsuits in international courts.

Expanding Bolivia's pipelines to Argentina and Brazil, and developing the gas to fill them, would cost $5.3 billion. “With these taxes and regional prices, investment is not viable,” says Mr Tavares. The new head of YPFB says that Bolivia will raise export prices to Argentina and Brazil.

Demand for gas in Brazil is rising sharply. The country risks an electricity shortage in 2009 unless it finds new sources of gas. The squeeze may be temporary: new finds offshore could turn Brazil into a gas exporter after 2012. Brazil's flirtation with Mr Chávez's pipeline may be a way to pressure Bolivia.

Chile is roaming for gas as well. Having all but given up on Bolivia, it has talked of importing from Peru. Unlike its competitors, Peru has courted investors. Repsol is among those investing in a $2.2 billion LNG project. But most of that gas is destined for Mexico and the United States. Chile is wary of dependence on Peru, with which its relations are often tense.

Getting gas right means allowing economic reason to prevail over political passion. Surprisingly, Venezuela's Mr Chávez may soon provide an example. He is about to lay the first bit of a 215km pipeline which will carry gas from Colombia. Joining him will be a neighbour who is a political adversary, Colombia's conservative president, Álvaro Uribe.

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Venezuela and the United States

Arms, votes and the man

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Hugo Chávez turns spycatcher

AS SPY scandals go, this one is more Austin Powers than James Bond. John Correa, an American military attaché declared *persona non grata* by the leftist government of President Hugo Chávez on February 2nd, holds the same rank—navy commander—as Ian Fleming's fictional 007. But the most sophisticated gadget he has been accused of using is an e-mail account. Mr Chávez claimed to have infiltrated the embassy so effectively that he even knew where the diplomats ate *reinas pepiadas*, a popular Venezuelan snack. William Brownfield, the United States' ambassador, responded that he had never eaten the snack in question in his life.

Mr Chávez, however, is not amused. He claimed that up to two dozen naval officers were supplying Commander Correa with classified information by e-mail. George Bush's administration, which denies the spying charges, responded by expelling the number two at the Venezuelan embassy in Washington DC, Jenny Figueredo, who was a political appointee rather than a diplomat.

The tit-for-tat expulsions mark a new low in relations between Mr Chávez and what he calls “the empire”. In recent months, the United States has adopted a low-key approach to Venezuela. It has ignored Mr Chávez's incendiary rhetoric while working to prevent him acquiring new military hardware. Its veto on the sale of American-licensed components may end up scuttling a deal with Spain for 12 naval reconnaissance and transport aircraft. Some of the spying—if such it was—concerned the Spanish planes.

The same fate may befall two other orders, one for Spanish patrol boats and another for ground-attack aircraft from Brazil's Embraer. Mr Chávez says he will look elsewhere, to China or to Russia, which is already supplying him with military helicopters and rifles. He has reiterated a plan to arm 1m citizens to deter an “imperialist” invasion. He also talks of a “strategic alliance” with Iran.

Meanwhile, Venezuela continues to send more than 1m barrels a day of oil to the United States. Mr Chávez faces a presidential election in December. His calls to forge “21st-century socialism” do not impress many Venezuelans as they watch their country's infrastructure crumble. But gringo-bashing goes down well. “Nationalism is a key connector between the leader and the masses,” says Luis Vicente León of Datanálisis, a polling firm. The Americans will continue to keep a close eye on Mr Chávez—and he will uncover more “imperialist plots”.

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Colombia's displaced people

No direction home

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A large, but neglected, human tragedy

Reuters

Suspended lives

EVERY DAY, Erica and Jordán, her son of 18 months, come to the same street corner in Bogotá's smart northern district to sell plastic bags or sweets. Sometimes they have nothing to sell, or are harassed by police, so they simply beg. She rarely makes more than 4,000 pesos a day (less than $2).

Five months ago, their lives were very different. Erica and her husband grew corn and plantains and had their own house in a small town in the western department of Chocó. Then Colombia's right-wing paramilitaries forcibly recruited her husband. Erica, like hundreds of thousands of other Colombians, many of them black women like her, was forced to leave home. Refugees in their own country, most make their way to the cities of Bogotá and Medellín. Perhaps 90% of them never return home.

Over the past decade, the conflict between the government, leftist guerrillas and the paramilitaries has uprooted some 2.5m Colombians—a number of "displaced people" surpassed only in Sudan. Colombia's *desplazados*, as they are called, are less visible than those of Africa. Rather than living in tented refugee camps, they melt into slums or shantytowns on the fringes of cities and of society.

For the first six months, they are supposed to receive food, help with housing, and advice from the government or the International Committee of the Red Cross (ICRC). After that, they are on their own. Before 2002, at least half of the refugees received no help at all. Distribution of emergency aid has since improved. But Juan Pedro Schaerer, of the ICRC's Bogotá office, admits that the scale of the problem is such that it is hard to cover everyone.

In 2004, Colombia's constitutional court ruled that the neglect of the *desplazados* amounted to a violation of their rights. It ordered the government of President Álvaro Uribe to cut red tape binding the 14 different agencies charged with helping the refugees, and to provide more money for aid. Unimpressed with the government's response, the court threatened criminal prosecutions of four ministers. Last November, the government announced a fivefold increase in its aid budget for the *desplazados*, to over $400m a year. The refugees' supporters have welcomed that, though they wonder how the government will find the money.

Mr Uribe's tough "democratic security" policy has cut violence in Colombia. Officials say the number of displaced people has fallen. In 2005, says the government, 136,000 people were displaced, 15% fewer than in 2004. CODHES, an NGO which works with *desplazados*, disagrees. It

claims 100,000 were displaced in the last four months of 2005 alone.

As so often in Colombia, behind the numbers game lie political disagreements. CODHES dislikes Mr Uribe's military campaign against the FARC guerrillas and favours a negotiated end to violence (something the FARC has shown no interest in). What does seem clear is that there are fewer incidents in which paramilitaries or guerrillas turn up and order entire villages to leave or be killed.

But more individuals are being forced to flee their homes. At the same time, an army offensive against guerrilla strongholds in the south has caused peasant farmers there to flee. CODHES claims that at least 17,000 people were displaced by American-backed aerial spraying of plantations of coca (the raw material for cocaine). The government counts these people as economic migrants, not *desplazados*.

Prodded by the courts, the government is finally doing more for the refugees. Patricia Luna, the official in charge, promises more help with housing and with schooling. That is vital, if part of the next generation of Colombian adults are not to be condemned to poverty.

Some, and perhaps many, *desplazados*, have not registered for help. Erica said she was scared to do so, and lacked the money to travel to a registration centre (though there are many of these around the country). She is looking for work as a maid. Opinion polls suggest that a large majority of Colombians back Mr Uribe's security policies, and are likely to give him a second term in a presidential election in May. Erica is not one of them.

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Canada's new government

Cutting corners

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Surprises in Stephen Harper's cabinet

IN PUTTING together his first cabinet, Stephen Harper has shown the same streak of ruthless skill which he deployed in piloting his Conservative Party to an initially unexpected victory in last month's federal election, ending a dozen years of Liberal rule in Canada. Mr Harper's political base is in the West. His party won no seats in Canada's three biggest cities. But the new prime minister has gone to great lengths to fill his cabinet with ministers from Ontario and Quebec. Already, it seems, he has one eye on a fresh election at which he would try to provide his minority government with a parliamentary majority.

In seeking geographical balance, Mr Harper cut a couple of corners. He named Michael Fortier, his party co-chairman, to the politically important job of public-works minister, appointing him to the Senate for the purpose. That broke two Conservative principles. The party has long favoured an elected Senate. And Mr Harper made accountable government a campaign theme, denouncing Liberal sleaze in the public-works ministry. The new minister will be beyond the scrutiny of the House of Commons. But Mr Fortier is from Montreal. And the Conservatives have high hopes next time of adding to the ten seats they won in Quebec.

The second surprise was the appointment of a Liberal defector, David Emerson, as trade minister. He was industry minister under Paul Martin, the defeated prime minister, and last month held his Vancouver seat for the Liberals. Mr Emerson was once the head of the forestry industry lobby. He will continue Canada's battle to get the United States to drop duties on softwood lumber.

The finance minister, Jim Flaherty, briefly held the same post in the Conservative administration that ran Ontario from 1995-2003. It was notable for cutting taxes, but also for recording a fiscal deficit despite slashing services.

Mr Harper clearly hopes to run a tight ship. His cabinet has only 27 ministers, down from Mr Martin's 37. He has not appointed a deputy prime minister. His party's deputy-leader, Peter MacKay, has been rewarded with the foreign ministry, although he has little experience of international affairs. Mr Harper's team is less diverse than Mr Martin's, but it has six women and two Asian-Canadians.

Thanks to Mr Emerson's defection, Mr Harper now has 125 of the 308 seats in the House of Commons. At a pinch, he might be able to secure a majority through an incongruous deal with the leftish New Democrats. He may not need to: the opposition is still licking its wounds, and Mr Harper can probably count on a year or two to act on his main pledges. These include a new child-care voucher, a cut in the sales tax, tougher sentences for gun crime and a plan to cut waiting times in the health service. He will then hope that his geographically variegated cabinet will help him to win outright the election that sooner or later will follow.

North Korea and those six-party talks

A frustrating game of carrots and sticks

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Tensions persist over how to tackle the North Korean nuclear problem

IF THE output of excuses were factored in to the measure of GDP, North Korea's economy would not be the basket-case it is. Over recent years, the regime has given a variety of reasons for its reluctance to show up for six-party talks about its nuclear bomb-making. When it finally agreed, last September, to a set of principles that included getting rid of its nuclear programmes (a first public hint that it has dabbled with potentially bomb-useable uranium, as America insists, as well as plutonium) in return for security assurances and aid, America, South Korea, Japan, China and Russia may have hoped for progress at last. But a later meeting ended in discord. Tensions among the five are now starting to show.

The excuse this time for North Korea's boycott of further talks has been America's crackdown on the various other illicit activities that help pay for its nuclear moonlighting. These include production of fake drugs and cigarettes, currency counterfeiting, illegal trade in endangered species, money laundering and trade in missiles and other weapons.

As the six were signing their joint agreement last September, America's Treasury Department took aim at a Macao-based bank, Banco Delta Asia, for laundering cash on North Korea's behalf. China, shown the evidence, moved swiftly to investigate, hoping perhaps to deflect attention from some of its state-owned banks that have dealings with the North. Later last year, adding muscle to a new inter-agency Illicit Activities Initiative, America slapped sanctions on eight North Korean companies which it accused of weapons proliferation.

No one much doubts that North Korea is a racketeering state. Tonnes of illicit goods have turned up all over Asia in recent years. Its diplomats have been expelled from a variety of countries for engaging in criminal activity. Its fake $100 bills, called “supernotes”, are reckoned to be the best in the business. Both Japan and Taiwan have reportedly stumbled across large stashes of them in recent years. In October last year, America issued indictments against a group of individuals, including a senior member of an off-shoot of the Provisional IRA, for allegedly seeking to distribute millions of dollars' worth of the fake bills.

According to recent remarks by David Asher, who dealt with these issues in America's State Department before joining the Washington-based Institute for Defence Analyses, the criminal sector may account for as much as 35-40% of North Korea's exports, and a much larger percentage of its total cash earnings, since margins are usually high. (Different estimates of these ill-gotten gains range from $500m to $1 billion a year.) But why go after North Korea so aggressively right now?

Counterfeiting a country's currency, Mr Asher points out, is “an act of economic warfare”. But it has been difficult getting hard evidence of what North Korea is up to. To cover its tracks and widen its distribution network, it has linked up with some of China's triad gangs. But straightforward law enforcement is also seen by some in the Bush administration as a useful tool to squeeze North Korea, in the hope of forcing the regime to change its behaviour. America's chief negotiator, Christopher Hill, has sought to persuade the regime that it has more to gain from economic reform and legal trade with the outside world. He is expected to meet his counterparts soon to try again.

But will the six-party talks then resume? This week Japan and North Korea met for the first time in a long while to resume formal talks about normalisation of diplomatic relations, economic assistance and the fate of a number of Japanese citizens thought to have been abducted to the North. Optimists take that as a sign that North Korea may be getting ready to pick up the nuclear negotiations too. Pessimists, says Mitchell Reiss of America's William and Mary College, worry that Japan (in range of the North's missiles) is getting impatient at the slow pace of the nuclear talks and might be prepared to cut its own deal. This week's talks made little progress, however.

If the wider talks don't resume soon, China, as convener, will have egg on its face. Its trade and investment in North Korea are estimated to be running at up to $2 billion a year. Preferring to coax North Korea into better behaviour rather than confront it, China's president, Hu Jintao, paid a rare visit to the North's Kim Jong Il last October. Rumour has it (China never says) that he promised another $2 billion in aid, and much more in investment. And last month Mr Kim toured one of China's most successful cities, Shenzhen, to see where economic reforms could lead.

But America and Japan in particular worry that such largesse, far from being an incentive to change, will lead Mr Kim to think he can drag out the nuclear talks indefinitely. Both China and South Korea by now send enough food aid to North Korea between them that at the turn of the year it could afford to bar international aid agencies that had been helping to feed hungry North Koreans since a famine in the mid-1990s. Private food markets, allowed when food was scarcer, are now facing new restrictions, with the government resuming control of food distribution. Tensions between America and South Korea over how best to tackle the North Korea problem were not dispelled when the two inaugurated a high-level strategic dialogue last month.

Frustrations on all sides at the difficulty of dealing with prickly North Korea are real. But the other countries round the table have their differences too. Mr Kim will work to widen any splits he can find.

Thailand

Thaksin's yellow peril

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From The Economist print edition

But the prime minister's not finished yet

AFP

People, not power

THE biggest protest Bangkok has seen in years—perhaps since the huge demonstrations of 1992 that led to the restoration of democracy in Thailand—gathered outside the royal palace on February 4th, to demand the resignation of the prime minister, Thaksin Shinawatra. The organisers encouraged protesters to wear or carry something yellow, a colour with royal and Buddhist connotations but also a deliberate echo of the "colour revolutions" in Ukraine and elsewhere. They put the crowd at 100,000, others perhaps half that number. The chief organiser, Sondhi Limthongkul, a media tycoon who has turned from friend to foe of Mr Thaksin, promises another massive show of popular discontent outside the palace this weekend. The prime minister failed to make him move it somewhere less prominent.

There have been rumblings of dissent in government circles: two cabinet ministers and the head of the state electricity-generating firm have resigned in recent days. Mr Thaksin's opponents hope disgruntled legislators from the ruling Thai Rak Thai party will break away and support planned no-confidence or censure motions in parliament. They are also seeking impeachment proceedings, and have petitioned King Bhumibol to order the prime minister to quit or call elections.

Mr Thaksin had hoped his family's sale last month of its controlling stake in Shin Corp, his telecoms and media empire, would draw the sting from his opponents' constant accusations of conflicts of interest, favouritism and corruption. But the criticism has only grown. It has emerged that the prime ministerial clan used a loophole (albeit a legal one) to avoid tax on the near $2 billion they raked in from the transaction; just as serious, suspicions were raised about share dealings linked to the sale. Thailand's Securities and Exchange Commission is investigating. These concerns gave a new momentum to Mr Sondhi's anti-Thaksin rallies, which have been simmering on for months.

Reading Thai newspapers' coverage over the past few days, it is all too easy to believe that Mr Thaksin's downfall is only a matter of time. But there are good reasons not to write him off just yet. His party still has a huge parliamentary majority. The small, bolshy faction the resigned ministers belong to lacks the power to swing any no-confidence vote.

And, as Mr Thaksin bluntly puts it, the "stupid" protesters are forgetting how, just a year ago, the votes of 19m Thais gave him a sweeping re-election victory. A policeman before he became a tycoon, the earthy Mr Thaksin retains his popularity among rural voters, who like his promises to spread the benefits of the country's economic growth more widely. Though doubts have long been

raised about his business dealings, the opposition Democrats' accusations of crookery ring hollow given the scandals that have erupted over public-works contracts at the Democrat-run Bangkok city government.

Mr Thaksin plans to let his opponents keep waving their yellow scarves and banners until they get tired and go home. It may indeed be hard to maintain the protests' momentum until parliament reconvenes next month. In the 1992 uprising and another in 1973, the king intervened to bring down military dictators, amid serious violence. This time is different: the protests have been peaceful and Mr Thaksin enjoys a strong mandate. Things could change if serious misdeeds are proved. But even then he might simply take his opponents at their word and call elections, which he could very well win.

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Indian privatisation

Not yet terminal

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Eyeball to eyeball with the government at India's biggest airports, the left blinks

THE choice of battlefield took even some members of the government by surprise. Since coming to power in May 2004, India's ruling coalition, led by the Congress party, has had numerous showdowns with the Communist parties whose votes it depends on for a majority in parliament. Too often, they have ended in the delay, cancellation or reversal of an economic reform, with the idea of privatisation, or even the selling-off of minority stakes, being the most notable casualty. But on February 4th, having bravely taken on the left over the partial privatisation of Delhi and Mumbai airports, and weathered a national airport strike, the government won an important victory.

“They raised the stakes very high,” said Mahesh Rangarajan, a political analyst, of the Communist parties and the trade unions, “and the government called their bluff.” At issue were contracts awarded at the end of last month for the modernisation of the two airports by two private-sector groups. The left argued, unsurprisingly enough, that the state-owned airport authority, not private companies, should be entrusted with this task. When the left was ignored, it called a strike, involving 22,000 airport workers across the country. Air-traffic controllers and flight crews were still working, so planes continued to take off, though there were cancellations in Kolkata (Calcutta), where the communists are strongest. But across the country, airports were filthy, luggage trolleys missing, and tempers frayed.

Correcting India's “infrastructure deficit”, probably the biggest single constraint on its economic development, is one of the government's central aims. And, hobbled by a big budget deficit, that inevitably requires mobilising private capital. So the government stood firm. In response, the Communist parties made clear that this was not an issue over which they would bring down the government. In exchange for a promise that no workers would find themselves jobless, the unions called off the strike. M.K. Pandhe, president of the Centre of Indian Trade Unions, a Communist group, made much of a promise that the government would discuss privatisation in a “co-ordination committee” meeting with the left parties. Yet there was no disguising the left's defeat.

It coincided with another incident where the government disregarded its Communist partners' concern—a vote at the International Atomic Energy Agency to report Iran's nuclear programme to the United Nations Security Council. That, in turn, followed a shuffle of the cabinet, which saw the petroleum ministry taken away from Mani Shankar Aiyar, who had been an enthusiastic promoter of closer energy links with Iran. Both moves were decried on the left as ideological sacrifices made for the sake of a much-vaunted new “partnership” with America, whose president is to visit next month.

With elections due in a few months in the states of West Bengal, where Communists are in power, and Kerala, where they are likely to regain it, tensions between Congress and its allies are likely to rise—but not to the point where the central government is threatened. The airport furore has shown that the government has far greater freedom to pursue difficult reforms than it has

previously appeared to think.

Long-suffering travellers at India's shabby airports, however, are not in the clear yet. The shambolic bidding process for the modernisation concessions has left the way open for legal challenges. Having faced down the workers, the government will now have to see off the capitalists and their lawyers. That could be harder.

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Nepal

A hollow bid to cling to power

Feb 9th 2006 | BIRATNAGAR AND KATMANDU
From The Economist print edition

A farcical election worsens the country's plight

EPA

All the king's men

IT WAS easy to find the polling stations in Katmandu for the municipal elections held on February 8th. In an eerily empty city, they were given away not by thronging voters but by armoured cars and sandbags, and large contingents of armed policemen and soldiers, under orders to shoot anyone trying to disrupt the voting. Only a trickle of voters appeared.

There were plenty of reasons to stay away. Maoist insurgents, blamed for the killing of two candidates, had called a week-long national strike to foil the election, and had staged daily attacks. The parties holding more than 90% of the seats in Nepal's last parliament had called a boycott. Of 4,146 local-government posts at stake in 58 of Nepal's 75 districts, more than half had no candidates at all and a third had only one. Nearly 650 candidates had withdrawn, surprised to find themselves nominated.

The sheer pointlessness of the exercise seemed evident to everyone except the royal government. For King Gyanendra, who seized dictatorial power a year ago, this was part of a promised return to democracy, to be followed by parliamentary elections next year. But even foreign governments, who have been urging him to restore democracy, condemned the election as, in the words of America's State Department spokesman, “a hollow attempt to legitimise power”.

As polls closed, the Maoists claimed victory for their campaign against the vote and ended their strike. A seven-member alliance of the main democratic parties also declared its boycott a total success. But the election commission reported a national voter turnout of about 20%, a respectable, if disputed, tally. A random sample in Katmandu suggested that voters were mainly civil servants and soldiers acting on orders. The winning candidates, naturally, were almost all royalists.

If Maoists, parties and monarchy could all claim victory, the country as a whole continued to lose out. Since ending a unilateral four-month ceasefire last month, the Maoists have renewed their insurgency, which marks its tenth anniversary on February 13th, with redoubled violence. In the southern town of Biratnagar, for example, the local Maoist leadership threatened to kill anyone supporting the elections. Bombs placed on a road near the town injured around a dozen people, including children, and blinded a soldier sent to defuse them.

For his part, to hold the election at all, the king had to step up repression. Hundreds of politicians

and activists were locked up in Katmandu last month. In Biratnagar, opposition activists said that 80 of their members were being held without charge before the election. More than 130 protesters were arrested there on polling day, and in Ghorahi, in the western district of Dang, soldiers opened fire on demonstrators protesting against the elections, killing one activist and detaining hundreds.

If elections prove so difficult in the cities, where the army is well entrenched, they are almost unthinkable in the countryside, where Maoist influence is even stronger. Since last November, the Maoists and the parties have been loosely allied, with the Maoists agreeing to join mainstream politics and contest elections under international supervision. Peace, however, or at least a truce, would have to come first. King Gyanendra's refusal to contemplate this suggests either that he is under the illusion the army can defeat the Maoists militarily; or perhaps that he needs the insurgency to continue. After all, that was his justification for restoring an absolute monarchy.

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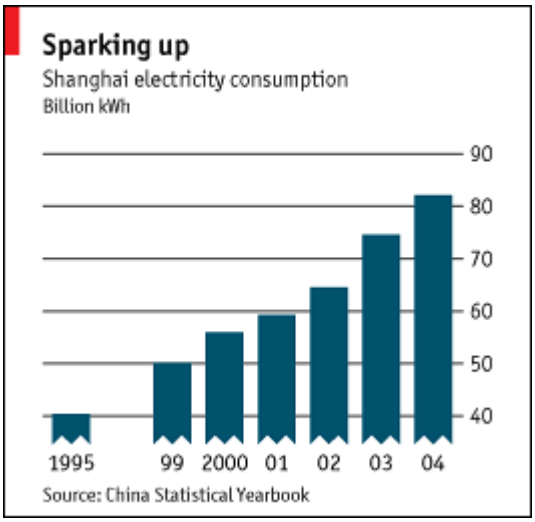
China

Power to the people

Feb 9th 2006 | BEIJING
From The Economist print edition

The government is winning the battle against outages

IN THE summer of 2004, Shanghai, like many Chinese cities, was grappling with debilitating power shortages. Neon lights were ordered switched off, air conditioning was restricted, and rationing forced factories either to rely on diesel generators or suffer intermittent stoppages. But Shanghai's mayor, Han Zheng, was confident that the dire situation would turn around soon enough. He argued that so many new generating plants were already approved or under construction that Shanghai would soon double its existing capacity. “If you come back in three years,” he predicted, “you will instead be asking me, ‘Mr Mayor, what will Shanghai do with all of its surplus power?'”



His predictions look like being right. Shortages were indeed less acute in 2005, and officials recently announced that after mild shortages during the summer peak season, electricity supply and demand will achieve rough balance by the end of the year. Two of China's top power producers, Huaneng Power International and Datang International Power Generation, reported output increases in 2005 of 31.7% and 27.1% respectively.

This year alone, China expects to add a staggering 81 gigawatts of new capacity. Over the next five years, the government plans to invest 600 billion yuan ($75 billion) in still more power plants. The State Grid Corporation of China, meanwhile, plans to spend 800 billion yuan over the same period, expanding and upgrading its transmission networks.

All this new investment has prompted worries of a power glut, and some muttering from officials about the possible need to curb investment in order to prevent oversupply. But it was just such concerns that led to the shortages of recent years. In its planning for the 2001-05 period, China forecast 5% annual increases in power demand, but actual rises were more than twice as much in each of those years.

With economic growth expected to remain at or near double-digit rates for the foreseeable future, China will see no shortage of new factories, homes and commercial properties needing to plug into the grid. Rising living standards mean more of those will be using power-hungry appliances and air-conditioning systems. China's power consumption per head stands at only about half the world average, and is just a fraction of that in developed countries. But no one doubts it will continue to rise.

Rising also is China's demand for oil. Here too, officials are waxing optimistic, at least for the short term. China this month proudly noted that its ratio of imported oil declined 2.2 percentage points to 42.9% last year. Overall oil consumption actually dropped slightly last year. While the government was quick to credit its successful conservation policies, the reduction probably had more to do with last year's high oil prices. In the longer term, though, oil demand can only rise. China now makes and sells more than a quarter of a million cars each month, and the nation's efforts to secure stakes in foreign oil supplies are ample testimony to the government's view on future rising demand. Recent good news notwithstanding, it will be a challenge to keep the lights burning and the cars running on the streets of Shanghai.

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The Philippines

It's no game

Feb 9th 2006 | MANILA
From The Economist print edition

A frenzy born of poverty

AFTER a stampede that crushed to death 74 would-be participants in a television programme and injured hundreds more, the head of an official inquiry said the crowd of mostly poor Filipinos at the event had been “exploited, manipulated and treated like animals”. He was referring to the inadequacy of crowd control arrangements at the sports stadium where the ABS-CBN television network was to have recorded a special edition of a game show called “Wowowee”. But his choice of words reflects wider misgivings, expressed in a bout of public hand-wringing provoked by the calamity, about attitudes towards the poor.

Three days before the event, people had begun gathering at the stadium in the hope of getting free tickets that would give them the chance to compete. The prizes included 1m pesos ($19,300) in cash, a house, taxi cabs and motor tricycles—prizes with particular appeal to the two-fifths of the population who live on less than $2 a day. By the morning of February 4th, the crowd had grown to 30,000. The stadium can accommodate 19,000. The stampede began when the organisers began to distribute tickets, an exercise that the head of the inquiry likened to “throwing a small slice of meat to a pack of hungry wolves.”

On seeing the television pictures of the heaps of corpses, politicians and commentators in the media struck up a chorus of lament about what one called a culture of mendicancy, in which a poor Filipino's best hope of advancing himself is to win a prize in a game show. And the chorus voiced distaste that ABS-CBN and other networks should profit from hugely popular shows such as “Wowowee”, which attracts much advertising for toiletries. The argument was even advanced that the government was somehow to blame for the stampede on the ground that it has so far failed to eradicate poverty. The government dismissed this as absurd.

Prosecutors are considering whether the organisers can be held criminally liable for negligence. ABS-CBN, part of a powerful conglomerate that does not always see eye-to-eye with the government, has expressed outrage at being accused of treating people like animals. It has undertaken to pay the medical bills of the injured and the funeral expenses of the dead.

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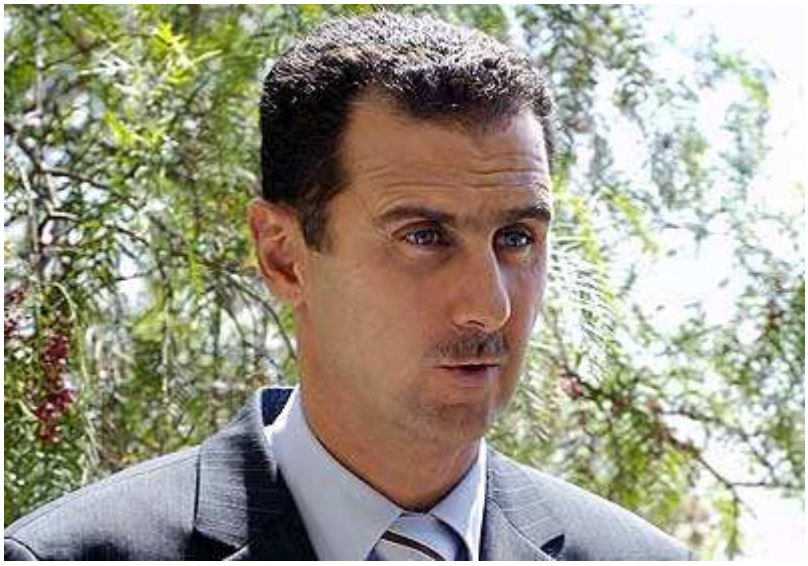
Syria

He doesn't know where to go

Feb 9th 2006 | DAMASCUS
From The Economist print edition

Getty Images



Bashar Assad is unsure which way to jump, while the West, especially the United States, is unsure how or where to push him

THE decaying yet doggedly durable regime of President Bashar Assad has been wobbling between two contrary methods of survival. One is to proffer the hand of friendship—to Turkey, to the West, to the European Union, even to the Americans and even to the government's foes at home. Recent examples of this more emollient tactic were last month's release of five leading dissidents, the continued tightening of Syria's border to staunch the flow of jihadists into Iraq and a harsher scrutiny of young Arab men arriving at Damascus airport for the same suspected purpose.

The other, quite opposite, approach is to wave a furiously defiant Baathist fist at most of the rest of the world; flaunt Syria's friendship with Iran and its belligerent new president, Mahmoud Ahmadinejad (see article), who was gleefully hugged by Mr Assad last month in Damascus; sing the praises of Palestinian rejectionists, including its most violent group, Islamic Jihad, which is still hosted in the Syrian capital; promote the cause of Hizbullah, the fiercely anti-Israeli Shia movement-cum-militia in southern Lebanon; heap scorn on the United Nations commission of inquiry that has pointed a finger of suspicion at the Syrian government for last year's assassination of Rafik Hariri, a long-time Lebanese prime minister; and parade Syria as the last bastion of pan-Arab pride in the face of the plotting and bullying of the evil, Zionist-led West.

In the last few weeks, this second, more bloody-minded, approach has prevailed. It is unlikely that the Danish and Norwegian embassies would have been torched by a mob protesting at the publication of cartoons ridiculing the Prophet Muhammad, as happened last week, without the

connivance of Syria's authorities. Mr Assad has ostentatiously embraced Mr Ahmadinejad just when Iran is facing its sternest pressure from the West to cease its nuclear dabbling. At an Arab Bar Association meeting in Damascus, just after the Iranian visit, Mr Assad castigated the West for a range of sins, while the audience chanted “Death to America!” and other such slogans, one in praise of Saddam Hussein.

In recent resentful remarks about Lebanon, which Syria controlled until last summer, Mr Assad still sounds loth to come to terms with his humiliating retreat from his much smaller neighbour. In particular, he shows no willingness to consider sacking, let alone hand over for trial, some of his closest family members, including his brother-in-law, Asef Shawkat, head of Syrian intelligence, or his brother, Maher Assad, a leader of his presidential guard, both of whom the UN commission has clearly if indirectly marked down as leading suspects in Mr Hariri's murder case.

Plainly, Mr Assad is in a bind—and cannot see how to wriggle out of it. Some hopeful reform-minded Syrians have argued that he would help himself if he loosened up the system, winning popularity and room for manoeuvre. Hopes that he might follow this course burgeoned during a brief “Damascus spring” after his father's death, in the summer of 2000, until the autumn of 2001, when he clamped down again. Then, in the run-up to a Baath Party congress last summer, hopeful talk resumed: he might open Syria up to a multi-party system, though no party would be based on ethnicity or religion; the emergency laws in force for decades might, it was rumoured, be dropped; special and military courts could be phased out; even the constitution's contentious Article 8, declaring that “the Arab Socialist Baath Party must lead society and the state”, might, it was surmised, be adjusted.

In the event, nothing fundamental happened. A few members of his father's old guard were sidelined; the economy is very slowly being loosened; dissidents are definitely less frightened than they were. But in set-piece presidential speeches in November and again last month, Mr Assad has dashed the optimists' hopes that he will take bolder strides towards a general liberalisation. Lately, the tone has become surlier and more confrontational.

This is partly because of Lebanon. The killing of Mr Hariri exactly a year ago was a massive blunder, leading to a revolution on the streets of Beirut, the Lebanese capital, that ended up with the complete withdrawal, last summer, of regular Syrian forces. The two UN reports, in October and December, by a German investigator, Detlev Mehlis, were a damning indictment of Syrian rule and vicious chicanery.

Other events have weakened Mr Assad. In October, just before the first UN report came out, Ghazi Kanaan, his interior minister who had run Lebanon for 20 years until 2002 as Syria's proconsul there, committed suicide in unexplained circumstances. This rattled Syria's Alawite minority (some 10% of the population), which has hogged power since Assad senior took over in a coup 36 years ago. Then, in January, Abdel Halim Khaddam, a Sunni who was a vice-president for 21 years until his ousting last summer, vented his fury against Mr Assad from exile in Paris, accusing him of involvement in the Hariri murder and promising to set up a rival government. Foes of the regime in Syria have refused to welcome Mr Khaddam into their camp but have cheered his public airing of the regime's very dirty laundry.

In the face of such embarrassments, the government's rhetoric has become more outlandish. Syria is a victim of a western and Zionist plot. Ministers ritually blame Israel for the Hariri murder—and presumably for the string of assassinations of other prominent anti-Syrian Lebanese people since Syria's withdrawal of forces last year. “Who else does it benefit?” asks a senior minister, Bouthaina Shabaan, conspiratorially. This week, reflecting on the

German chancellor's recent visit to Israel, she writes that Germany is “willing to do what it takes to redeem itself, even if it finances a second Holocaust against the Palestinian people.” The state-run Syrian press habitually accuses the West of waging war on Arabs and Islam, with Syria as a chief victim.

Everyone is beastly to us

To a degree, this may work. Syrians do feel unfairly isolated. They are bitter about losing Lebanon, and tend to think the Lebanese ungrateful. Many are convinced that even the UN, through Mr Mehlis's report, is “out to get them”. They think America will punish them, whatever they do. And Mr Assad may still personally be quite popular, though that is plainly hard to gauge in the absence of open politics.

Yet the drab economy, high unemployment, soaring housing costs, lack of individual and press freedoms, and the knowledge that the present oil windfall will end in eight to ten years when Syria's reserves are expected to run out, all feed a well of resentment—particularly against Syria's corrupt elite, widely referred to as a mafia, that leeches off the Assad regime.

The opposition is weak and divided but has been gaining courage, especially since the release, last month, of five prominent figures imprisoned when the Damascus spring reverted to winter in 2001. The quintet's leading light is Riad Seif, a popular, secular-minded Sunni businessman and former MP who, while still in prison, co-signed the “Damascus declaration”, a blueprint for reform and freedom issued last October. If Mr Seif were allowed a platform, which may not be likely soon, he could fast gain a big following.

The other key figure is Sadreddin Bayanouni, head of the Syrian branch of the Muslim Brotherhood, who has lived in exile since 1981 and has let it be known that he approved of the declaration. The Brotherhood is still almost certainly the strongest underground opposition, though it was savagely suppressed by Assad senior in the early 1980s; membership of it is still punishable by death. The most potent change among opponents of the regime is that the Islamists and the secularists now seem more willing to build a joint front. Mr Bayanouni, for instance, insists that the Brotherhood would not seek to set up a theocratic state or enforce *sharia* law. Mr Seif goes out of his way to sound polite about the Islamists.

Toxic Washington

A gathering of the Syrian opposition at the end of last month in Washington notably excluded Farid Ghadry, who founded the liberal Reform Party of Syria in 2001, on the ground that he was too close to the Washington neo-conservatives. Indeed, he has been dubbed “the Syrian Chalabi”, after the neo-cons' Iraq favourite who got less than 1% of the vote in December's Iraqi election. Like Mr Chalabi, Mr Ghadry, aged 51, has spent most of his life in exile. Syrian human-rights campaigners and opponents of Mr Assad virtually all emphasise their hostility to America and Israel.

Relatively reform-minded members of Syria's government, such as Mrs Shabaan and Abdullah Dardari, a go-ahead deputy prime minister who is trying to liberalise the economy with scant help from most of his colleagues, insist that Mr Assad is bent on gradually opening up both economics and politics, with a multi-party law expected later this year. But many independent-minded Syrians doubt whether a system so corrupt and centralised is capable of reform—without collapsing.

The American administration, which has imposed partial sanctions on Syria, is unsure how to proceed. The excited expectation among neo-conservatives in Washington three years ago that Mr Assad's regime was “low-hanging fruit” has given way to a nervy and frustrating sense of stalemate. The mantra of regime change has been replaced by calls for the regime to “change its behaviour” and for “change *within* the regime”: ie, Mr Assad must get out of Lebanon completely, force Hizbullah to disarm (he won't yet), eject Palestinian rejectionists from Damascus (he may tell them to lie low), tighten the border with Iraq (he has tried to, but it is 600km long), and sack the nastiest in the ruling establishment. Mr Assad may, after Mr Kanaan's demise, offer up Rostom Ghazale, his successor as Syria's proconsul in Lebanon, for sacrifice too. But it is hard to see him ditching his brother or brother-in-law, the two key men in a security state, without cutting his own throat, metaphorically if not literally.

Mr Assad's recent oscillations, most recently back towards rhetorical confrontation, suggest despair, even panic. Some question the degree to which a dictatorship that has been isolated for so long has a grip on reality. “He may have begun to believe his own rhetoric,” says a seasoned diplomat. A leading Damascene journalist hints that there may be a *fin de régime* recklessness in the air, a sense that “if we're cornered we can still destabilise the whole of the Middle East.” In any event, there is scant sign of Mr Assad pondering either a dignified exit or the risk of allowing the Baath party to share power. In fact, there is no sign that he has any plan at all.

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Iran

The president gets stronger at home

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A populist president, reviled abroad, may be making strides at home

AFP

A president who touches the heart

SPORTING his trademark Palestinian *kaffieh* round his neck, he fulminates against the governors at the International Atomic Energy Agency (IAEA), the United Nations' nuclear watchdog, which reported Iran to the UN Security Council on February 4th on suspicion of trying to make nuclear bombs. He accuses those European newspaper editors who invoke freedom of expression while caricaturing the Prophet Muhammad of hushing up the suffering of Palestinians at the hands of Israel. If anyone is enjoying the recent turn for the worse in relations between the western and Islamic worlds, it is Iran's president, Mahmoud Ahmadinejad.

Iran reacted boldly to the governors' resolution, which was passed, ominously for the Islamic Republic, with the support of all five permanent members of the UN Security Council. The Iranians have scaled back their co-operation with IAEA inspectors and announced that a date, revealed only to the agency, has been fixed for resuming the uranium-enrichment research that they suspended three years ago. Iran's calibrated escalation—officials have disclaimed, for instance, any intention of leaving the Nuclear Non-Proliferation Treaty—bore the imprimatur of the supreme leader, Ayatollah Ali Khamenei. But it is Mr Ahmadinejad, in the eyes of the world, who embodies Iran's assertiveness.

From the perspective of the country's religious establishment, this may not be a bad thing. As recently as last autumn, senior members of the clerical aristocracy derided Mr Ahmadinejad's unpolished style as a liability to efforts then under way to win international acceptance for Iran's nuclear programme. Now that those efforts have ended, and confrontation is in the air, the president's populist rhetoric of religiosity and social justice, combined with his rabble-rousing nationalism, is proving quite a help.

It would be ironic if increased international pressure, which some American conservatives hope will encourage Iranians to rise against their clerical leaders, were to elicit a nationalist reaction from citizens who otherwise have little love for the Islamic Republic. But this is what top Iranians, aware that Iran faces formal referral to the Security Council and, in turn, the prospect of sanctions when the IAEA governors meet next month, are counting on.

The president's imaginative diatribes against leading western nations (“lions whose mane and fur have moulted”), coupled with a series of anti-Israel outbursts, have earned him notoriety in the

West and renown among many Muslims, not all of them fellow Shias. His ban on business between Iran and Denmark, which was announced on February 6th, was largely a symbolic act; there is not much business to ban. But he did not criticise the Islamic militiamen, known as the *basij*, who spent February 6th and 7th attacking Denmark's (evacuated) embassy in Tehran; ideologues such as these voted him into power.

Mr Ahmadinejad's other asset is his popularity in poor, neglected provinces. This was illustrated during a recent visit to the impoverished coastal province of Bushehr, where the Russians have been dragging their feet over completing Iran's first nuclear reactor. Like George Bush, although neither man would feel flattered by the comparison, Mr Ahmadinejad is more comfortable working sympathetic crowds than fielding questions from sophisticates in the capital. In Bushehr, he promised to create wealth, and also to have Mr Bush tried before a “people's tribunal” for supporting Israel. He was rapturously received.

Nationalism is easier on a full stomach and Mr Ahmadinejad is the rare and fortunate president who expects to receive, over the coming Iranian year, some $36 billion in oil export revenues to help buy loyalty. In his first budget bill, now before parliament, the government has promised to build 300,000 housing units, two-thirds of them outside big towns, and to maintain energy subsidies that amount to a staggering 10% of GDP. MPs may trim the budget, which they claim is inflationary in its present form, but they dare not blunt its populist thrust.

It is also notably generous to state entities that disseminate the official ideology. According to the draft before parliament, the state broadcasting monopoly and the Institute for Islamic Propagation, whose activities range from publishing books to proselytising abroad, are to benefit from budget rises of 46% and 96% respectively. The budget also formalises the subcontracting of public works to the *basij*–another step towards what some Iranians fear is the militarisation of public life.

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Israel and the Palestinians

The shape of things to come

Feb 9th 2006 | JERUSALEM
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Ehud Olmert makes his mark and begins to chart the future

A LITTLE over a month after Ariel Sharon's incapacitating stroke, Ehud Olmert has taken a step that his predecessor as prime minister never did. This week, in his first interview since taking over, he announced what final borders he intends Israel to have, and with that, implied that it will demarcate them without negotiating peace with the Palestinians first.

Politically, it looks like the definitive move by Mr Olmert, who is technically still acting prime minister, to put his own stamp on the office and project a reassuring decisiveness. Mr Sharon, with his long history as a general and as a territorial expansionist, enjoyed the confidence of Israelis to such an extent that after pulling out of the Jewish settlements in Gaza last summer, he was able to retain a studied vagueness about how much further he would go. Mr Olmert, a lawyer and politician all his life, did not have that luxury. Now Israelis will have no doubt what they are voting for if they support his Kadima ("Forwards") party in the election on March 28th.

His plan is to keep the three main blocks of West Bank settlements and all of Jerusalem, all on the western side of the barrier Israel is currently building, which bites off roughly 10% of the West Bank land; and also some as-yet-unspecified presence in the Jordan Valley, along the West Bank's eastern edge. Whether that is a final position, a negotiating stance (with an eye to giving up the Jordan Valley later) or a political posture (to look tough after the Islamist party, Hamas, swept the board in Palestinian elections last month) remains to be seen. In recent years the notion that an eastern buffer is essential to Israel's security has lost currency among the country's defence-establishment hawks, including Mr Sharon himself, though Hamas's victory may have revived it.

A Palestinian negotiating partner might never agree to such a deal, since a Palestinian state on what is left might be thought too constricted to be economically viable or peaceful. Which is why it seems clear that, although Mr Olmert did repeat his commitment to the internationally endorsed "road map" peace plan as the framework for talks with the Palestinian Authority (PA), he does not envisage such talks happening in the foreseeable future.

Indeed, he has pretty well said as much. Though Israel will maintain contact with the PA as long as Mahmoud Abbas, the current president, remains in charge, it says it will not deal with the PA and will stop transferring the tax and revenue it collects on the PA's behalf when Hamas forms a government, which is expected to happen some time after the Israeli election. This week Israel also resumed a campaign of targeted killings of Palestinians it says are active terrorists.

This tough stance seems to be working for Kadima. Its rating stayed steady after Hamas's victory in the Palestinian poll last month, overturning the assumption that a Palestinian radicalisation would strengthen the right-wing Likud party in Israel. The Likud position, of not giving up any land without Palestinian guarantees of security in return, now looks like a bad miscalculation. A poll this week for Tel Aviv University's Peace Index finds that 76% of Israeli Jews think that, in the light of

Hamas's victory, Israel should set its borders unilaterally. Israelis seem to be choosing the centrists' plan: separate from the Palestinians by any means necessary.

But that plan faces a challenge from another set of radicals, home-grown ones. The dismantling of a mere nine buildings in the Amona settlement outpost in the heart of the West Bank last week saw more violence and casualties than the whole of the Gaza disengagement. That was due to heavy-handed police and army tactics combined with fierce resistance by thousands of young settlers, hardened by their experiences in the summer and contemptuous of the moderating influence of older settler leaders whom they blame for the failure to prevent the Gaza pullout.

For now, Mr Olmert has weathered this challenge well too. He seems to have lost a little support over the clashes and the decision not to cut off PA revenues straightaway, but mainstream Israelis tend to blame the settler youth for the violence. At some point they may begin worrying—as religious Israeli Jews are already warning—that disengagement from the West Bank threatens to tear their own society apart. But that will come after the election. For now, unless there are renewed Palestinian attacks, Mr Olmert's position remains very strong.

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Sudan

Bring on the blue helmets

Feb 9th 2006 | NAIROBI
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Thousands of defenceless people in western Sudan still need protecting

Reuters

Waiting, as usual, for the blue helmets

SINCE the tragedy in Darfur, Sudan's western region, began three years ago, at least 200,000 people—some say more than 300,000—have died; another 2m, in a population of 6m, have been displaced, many of them fleeing across the border into Chad; peace talks in Nigeria between the rebels and the Sudanese government have stalled yet again; there is a risk of a proxy war breaking out between Chad and Sudan; and the African Union (AU), with some 7,000 ill-equipped troops, admits it cannot keep the peace. Now, belatedly, the UN is likely, as a last resort, to send blue helmets to Darfur.

The United States, which two years ago accused the Sudanese government of genocide, is driving the plan, and opposition to it is fading. The Sudanese government in Khartoum, which has armed and encouraged the mounted Arab militias, or *janjaweed*, responsible for most of the killing, has stopped denouncing the UN intervention idea out of hand. The AU, whose peacekeepers have proved sadly unable to stop the *janjaweed*'s campaign of rape, murder and pillage, has acknowledged that it needs the UN's help. And even China, which had opposed any UN intervention for fear of annoying Sudan's murderous government, from which it buys vast dollops of oil, is now unlikely to object. Last week, the UN Security Council asked Kofi Annan, the secretary-general, to “initiate contingency planning without delay” and to produce a range of options in consultation with the AU. Mr Annan's envoy to Sudan says a force of 12,000-20,000 peacekeepers would be appropriate.

Rapid intervention is especially needed because the suffering in Darfur has again got worse. Around 70,000 people fled the town of Mershing last week, after militiamen on horses and camels attacked it. In the resulting stampede, 13 children were reported to have been crushed to death

and another 220 went missing. Hundreds fled, many for the third or fourth time, across the border into Chad.

The head of the AU's mission accused one of Darfur's two main rebel groups of provoking the violence by attacking a government-held town shortly before. The AU has previously claimed to have photographs of government attack-helicopters strafing villages to support the marauding *janjaweed*. The AU again proved unable to prevent such crimes: its mission has almost no aviation oil for its two battered helicopters; in one sector of Darfur, which is bigger than Italy, 760 AU infantrymen are supposed to patrol some 12,000 sq km (4,600 square miles).

Relief from the UN, if it comes, will not come soon. A fact-finding mission must be dispatched to report on what kind of force Darfur needs. The Security Council would have to approve it, and peacekeepers would have to be found. They would probably not, at first, be numerous; the UN would aim to put blue helmets on the heads of those in the existing AU force.

It could still be tricky: few countries are keen to lend troops to the UN—and often do so only because their armies need the cash for boots and bullets, and get well reimbursed by the world body. There are currently 15 UN peacekeeping missions around the world. One in southern Sudan, where a much longer war recently ended with several million dead, is meant to have 10,000 troops, but so far has barely more than half that figure.

One idea would be for the UN Security Council to ask NATO to give temporary assistance to the AU, pending a full-blown UN mission's arrival. NATO has already airlifted eight battalions of AU soldiers and police into the zone; the European Union has airlifted one battalion. The United States, which is perennially sceptical about the UN's ability and wants NATO to do more peacekeeping, is keen on the idea. To cover this eventuality, a new mandate from the UN would be urgently needed.

The Americans are suggesting that NATO could provide the AU with more airlift and other logistical support, and could help with tactical planning and intelligence. Such help could probably be supplied, at a pinch, by the alliance's European members, but not attack-helicopters to enforce the no-fly zone over Darfur which is also patently needed.

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Europe's labour mobility

When east meets west

Feb 9th 2006 | BRUSSELS AND LONDON
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The evidence argues in favour of lifting all restrictions on labour migration from the new members of the European Union

THE headlines around Europe in the run-up to May 1st 2004 were depressingly similar. That was the day when ten new countries, mostly from central Europe, joined the European Union. Yet rather than celebrate, newspapers were filled with dire warnings of a flood of migrants who would steal jobs or sign up for welfare benefits. Under pressure, 12 of the 15 existing EU members imposed “transitional arrangements”—Brussels-speak for restrictions on labour from the east. Britain and Ireland stood alone in opening their markets to all, though even they adopted rules to stop benefit-seekers, and Britain created a registration scheme. Sweden also kept its labour market open, after its parliament rejected restrictions.

These transitional arrangements must be reviewed at the end of two years—ie, by April 30th. They can be extended for a maximum of five years. On February 8th the European Commission published a report on experience so far. It might be read as a controlled experiment, setting the 12 that chose restrictions against the three that did not. The commission's conclusions are unequivocal: all the evidence comes out strongly in favour of the three. They have had faster growth and more employment; the 12 either saw no effects or negative ones, notably more undeclared workers. The three's openness may not be the cause of their better performance, but it has not damaged them either.

The commission argues that the curbs are not merely unfair (freedom of movement is supposedly a fundamental right of all EU citizens). They also do not work. Those countries with the tightest

restrictions seem not to have appreciably fewer migrant workers. Indeed, the country that saw the biggest jump after 2004 was Austria, the fiercest believer in restrictions. What seems to have happened is that the restricters got the highest numbers who work illegally, declare themselves as self-employed, or say they are posted abroad from their home countries. As the report concludes, “there is no direct link between the magnitude of mobility flows...and the transitional arrangements in place.”

The fear that migrants from the east might push up unemployment also looks empty. For a start, too few have come to have much impact. In most EU 15 countries, workers from the new members make up less than 1% of the workforce: only in Ireland is the number as big as 3.8%. And far from stealing jobs from locals, most incomers have taken jobs that locals shun. That means better business, higher profits—and, ultimately, more employment. A striking finding is that, across the EU 15, migrant labour from the EU 10 has tended to be associated with rising employment rates, even for local workers.

Nor is there evidence of migrants taking up welfare benefits in large numbers. The overwhelming reason for their moving is to work, usually with an eye to returning home later, not to go on the dole.

This is not to deny that there are some pinch points. Irish seamen went on strike last year over their employers' use of cheap, non-union Latvian labour; Irish unions now want some restrictions. The two countries most chary of opening their labour markets, Germany and Austria, are the two that directly border the ex-communist east—Austrians point out that their wages are five times Slovakia's. Yet overall, says the commission, labour flows from the EU 10 have been too small to affect either job security or wages in the EU 15.

That finding is echoed by the World Bank's Ali Mansoor in a forthcoming study of migration in the post-communist world. He concludes that labour flows will tend to “unwind naturally”. Most people who move do not want to settle abroad, but to get cash and skills for a better life at home.

Yet such results remain sensitive. Comparing the final version of the commission's report with earlier drafts seen by *The Economist*, there was much watering-down, surely inspired by commissioners from countries keen to keep restrictions. A reference to the “extremely positive” experience of liberalised labour markets has become “generally positive”. A comparison with the bigger problem of illegal migration from outside the EU has been largely excised. Even this week, the (Czech) employment commissioner, Vladimir Spidla, would not come out with a firm recommendation to scrap restrictions.

Yet the commission's arguments seem to be hitting home. In December, the European Trade Union Confederation changed its line on labour mobility. With only its German and Austrian members dissenting, it voted to back the ending of all intra-EU restrictions. It now says it is better to have workers from the east as legal employees, who can be brought into collective bargaining and will pay taxes, than in dodgy, exploitable self-employment or outright illegality.

This suggests that the domestic debate may also be tilting in favour of liberalisation. Finland, Portugal, Spain and perhaps Greece now seem all but certain to ditch their transitional arrangements in May. Others are considering whether to liberalise a little (see table).

Greater labour mobility, whenever it comes, will be beneficial. The competitive challenge that lower-cost workers, whether from the EU 10 or elsewhere, will pose for the pampered, inflexible workforces of the old EU 15

will exist anyway. Those who would keep out workers from the east will find their efforts as vain as attempts to fend off globalisation.

Curb your enthusiasm

Country	Stance on labour restrictions
Austria	Five more years
Belgium	Mulling liberalisation
Denmark	Mulling liberalisation
Finland	Will scrap curbs
France	Modest liberalisation, at most
Germany	Five more years
Greece	Likely to liberalise
Italy	Unclear
Luxembourg	Mulling liberalisation
Netherlands	Mulling liberalisation
Portugal	Will scrap curbs
Spain	Likely to liberalise

Source: *The Economist*

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The French judicial system

Exit Napoleon

Feb 9th 2006 | PARIS
From The Economist print edition

A miscarriage of justice calls an entire system into question

Reuters

Burgaud under the spotlight

IT HAS been a landmark case in French judicial history in more ways than one. Since mid-January, a parliamentary inquiry has been studying one of the country's biggest post-war miscarriages of justice: how six innocent people, jailed for years in connection with a paedophile ring, were acquitted on appeal only last December, after it turned out that key evidence against them had been made up; and how seven other innocents spent months behind bars. The testimony of the acquitted has been televised live, gripping the public. This week, national TV channels cleared their schedules to broadcast the testimony of Fabrice Burgaud, the lead investigating judge in the case.

The affair began in 2000, when social workers suspected sexual abuse of children in Outreau, a suburb of Boulogne-sur-Mer in northern France. The following year (when neighbouring Belgium was being rocked by the trial of a serial rapist and murderer, Marc Dutroux), a judicial investigation into a suspected paedophile ring was opened, led by Mr Burgaud. Some 20 children were identified as victims, including those of three of the couples charged.

At the trial, in 2004, the central evidence was testimony by one of the accused, Myriam Delay, as well as by various children. Seven of the 17 accused were acquitted, after serving months of pre-trial detention. Of the ten found guilty, only four—including Mrs Delay—remain behind bars today, six having been acquitted on appeal in December. The stories told by the acquitted on television have been devastating: marriages wrecked, children taken into care, jobs lost, reputations in tatters. An 18th accused committed suicide in prison in 2002. A nervous Mr Burgaud, meanwhile, said this week that he had done his job “in all honesty”.

France has been shaken by what has become known as *l'affaire d'Outreau*. President Jacques Chirac made an unprecedented apology to the acquitted. Already, in 2004, Dominique Perben, then justice minister, had apologised to the first group of innocents. At a time when an introspective France is feeling uncertain about itself in many other respects—about Europe, about globalisation, about Islam—its judicial system is now under the spotlight too.

Many questions are being raised. How could the case have been mounted on such flimsy evidence? Why were there no safeguards that could have stopped it from going as far as it did? Do France's investigating judges have too many wide-ranging powers? Are they given too much responsibility too young? (Mr Burgaud was 29 when he took on the Outreau case.) Should they act single-handedly in sensitive cases? Should suspects' access to the defence be strengthened? Should an investigating judge's right to put suspects under official investigation, and in provisional

detention, be curtailed? Should the position itself be abolished?

Pascal Clément, the justice minister, has promised reforms after the parliamentary inquiry's final report is submitted, probably in May or June. But it is unclear how far he will go. Jean-François Burgelin, a retired top judge who has written widely about judicial reform, told *Le Figaro* this week that France needed to adopt elements of the “accusatorial” system—in which there are three distinct roles of prosecutor, defence and judge—but “without going all the way to Anglo-Saxon excess.” The French consider that the Anglo-American system is too costly to the state, and also that it discriminates against the poor. Even its critics, though, agree that France's judicial methods need to change. “The Napoleonic system”, declares Mr Burgelin, “has had its day.”

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Turkey and Islam

Sheikh, rattle and roll

Feb 9th 2006 | ANKARA AND BITLIS
From The Economist print edition

More incidents to challenge those who would modernise Islam

AFP

Veiled in prayer

IN AN ancient *madrassa* in the hills near Bitlis, a septuagenarian sheikh consults Islamic scriptures as he speaks over the phone. Sheikh Nureddin, a spiritual leader in Turkey's Kurdish south-east, is negotiating over a young woman hiding in his home. Hatice Kaya's in-laws have wanted her dead since November, when she was kidnapped by her childhood sweetheart and then abandoned. Only her blood can cleanse the stain of dishonour, the family insists. “Nonsense,” sniffs the sheikh. “Islam forgives, the Prophet forgives, and so will her husband.”

The mufti of Turkey's most westernised city, Istanbul, took a less liberal stand last month when a group of men and uncovered women were photographed praying together at the small Subasi mosque. Mustafa Cagrici decreed that there could be only one form of worship, as ordered by the Prophet. Men and women must pray separately lest they be tempted by naughty thoughts, and women must always cover their heads. He sent people to the mosque to hand out headscarves, though in the event neither the errant flock nor the hordes of uncovered women whom secularists hoped to see turned up.

The contrast between the sheikh and the mufti illustrates many paradoxes of Islam in Turkey. Mr Cagrici is an employee of the government body that micro-manages religious life and tells preachers what to say. Its main job is to keep Turks on the strictly secular path laid out by the father of modern Turkey, Kemal Ataturk. That means excluding women who wear the headscarf (ie, the majority of Turkish women) from schools and universities.

Sheikh Nureddin's *Nakshibendis*, one of the largest Muslim brotherhoods, is technically illegal. It and other Islamic fraternities were banned by Ataturk for being reactionary influences. Yet, after decades underground, the brotherhoods have re-emerged as a potent force with a largely moderating influence on Islam in Turkey. That has not kept Turkey's hawkish generals from demonising some of these movements' leaders.

Reconciling these contradictions in a way that satisfies both secular and pious Turks is one of the biggest challenges facing Turkey as it seeks to join the European Union. Turks pride themselves on being the most modern and democratic nation in the Islamic world, one that can serve as a bridge between East and West and help avert the “clash of civilisations”.

That claim was tested once again this week, when a teenager in Trabzon shouting “Allahu Akbar”

shot dead an Italian Roman Catholic priest. The boy later told police he had been influenced by the cartoons denigrating Muhammad. The affair is likely to be exploited by those in Europe who oppose Turkey's membership, even though attacks against Christians on religious grounds are extremely rare in Turkey.

It might have been worse: the killer could have said he was acting under the influence of a government-inspired campaign against missionaries. In an officially issued sermon, imams in Turkey have been talking up the dangers posed by Christian missionaries, who “work as a part of a plan to cut the ties of our citizens to the [Islamic] faith.” Christian missionaries, especially Protestants, complain that the authorities do little to protect them from vigilantes who stone their churches and send them death threats.

Such a combustible cocktail of zealotry and nationalism led to some speculation in the Islamist press that the worshippers at Subasi were part of an American plot to “christianise Muslims”. Perhaps they were connected to a female troublemaker and former *Wall Street Journal* reporter, Asra Nomani, who organised a mixed congregation of Muslims in New York last year. Yet most secular Turks reacted the other way, hoping that the exposure of the Subasi congregation would spark a broader debate on reform in Islam. As Ahmet Hakan, a liberal commentator, notes, Islam is in urgent need of theologians “who will combat the mentality that seeks to keep Islam under the hegemony of men.” As she awaits her fate in Bitlis, the young Hatice Kaya would surely agree.

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Russian politics

Vladimir who?

Feb 9th 2006 | MOSCOW
From The Economist print edition

Some fresh theories on the true meaning of Putinism

EVER since his sudden emergence as Russia's president when Boris Yeltsin abdicated at the end of 1999, Vladimir Putin has baffled analysis. What does this ex-spy (if there is such a thing: he himself once said that “there are no former chekists”), who pays lip service to free markets, really stand for? What other leaders does he resemble? The Putinology game has continued for six years now.

Hardly anyone still hopes that Mr Putin can become the democrat he sometimes claims to be; even “managed democracy” is no longer touted much. Early talk of the “Chinese model”—liberalised economic policy, but a tight political grip—may have been harsh on Mr Putin politically but optimistic economically. The “Pinochet model”, which some advocated, took little account of Russia's great-power ambitions, and overestimated its governability.

These days, the comparison of choice among some Russian liberals is to the Brezhnev era of the late 1970s and early 1980s. Then, too, high oil prices and westward energy sales accompanied prickly international relations. Vladimir Ryzhkov, a member of parliament, likens Mr Putin's manipulation of the Kremlin's clans to Brezhnev's politburo management. (The depressing comparison has an upside: when oil prices fell, so did the Soviet Union.) But, to be fair, Mr Putin's run-ins with the West pale beside the cold war; and, despite his KGB background, Russians are much freer now than they were then. Mr Putin himself recently denounced “Sovietologists” who see Russia through a cold-war prism, such as those who want to eject it from the G8 group of rich nations. “The dog keeps barking,” the president said, “but the caravan keeps rolling.”

Mussolini was once another fashionable comparator. But Yegor Gaidar, an architect of Mr Yeltsin's economic reforms, this week proposed an alternative: Weimar Germany. Mr Gaidar postulates that the pattern of the Yeltsin/Putin era—disorder and economic chaos, followed by authoritarianism and widespread imperial nostalgia—matches Germany in 1918-33. The implicit prognosis is unhappy: 15 years after military defeat in Germany, Hitler was elected chancellor, and it will soon be 15 years after the Soviet Union collapsed. “I hope it will not happen,” says Mr Gaidar, but “we should not close our eyes” to the danger. Lilia Shevtsova, of the Carnegie Moscow Centre, takes issue with part of the analogy: Mr Putin's “cocksure political class”, she says, is beyond imperial nostalgia and is busy reviving Russia's superpower status. Her preferred formulation is “bureaucratic authoritarianism”.

Another analyst, Andrei Illarionov, used to talk of the “Venezuela model”, in which state meddling in energy destabilises the economy (this may explain why he is no longer Mr Putin's economic adviser). Last week, he proposed a different idea: Nashism. *Nash* is Russian for ours; but it is also a play on *Nashi*, a youth movement founded by the Kremlin to help stave off an unlikely colour revolution, as well as on fascism. The most important value in Nashism, says Mr Illarionov, is loyalty to the regime; another feature is the unequal application of the law; and a main purpose is the redistribution of property. Nashism has several analogues, Mr Illarionov argues, in countries

such as Libya, Chad and Syria.

Piffle, says Vyacheslav Nikonov, a Kremlin-friendly political analyst. He diagnoses Mr Putin as a “Gaullist conservative”: liberal in economics, but robustly independent in foreign policy. And Mr Nikonov adds that, whatever else he is, “Putin is 100% Russian.”

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Charlemagne

The fertility bust

Feb 9th 2006
From The Economist print edition

Very low birth rates in Europe may be here to stay

FALLING populations—the despair of state pension systems—are often regarded with calmness, even a secret satisfaction, by ordinary people. Europeans no longer need large families to gather the harvest or to look after parents. They have used their good fortune to have fewer children, thinking this will make their lives better. Much of Europe is too crowded as it is. But is this all that is going on?

Germans have been agonising about recent European Union estimates suggesting that 30% of German women are, and will remain, childless. The number is a guess: Germany does not collect figures like this. But even if the share is 25%, as other surveys suggest, it is by far the highest in Europe.

Germany is something of an oddity in this. In most countries with low fertility, young women have their first child late, and stop at one. In Germany, women with children often have two or three. But many have none at all. Germany is also odd in experiencing low fertility for such a long time. Europe is demographically polarised. Countries in the north and west saw fertility fall early, in the 1960s. Recently, they have seen it stabilise or rise back towards replacement level (ie, 2.1 births per woman). Countries in the south and east, on the other hand, saw fertility rates fall much faster, more recently (often to below 1.3, a rate at which the population falls by half every 45 years). Germany combines both. Its fertility rate fell below 2 in 1971. But it has stayed low and is still only just above 1.3.

This challenges the notion that European fertility is likely to stabilise at tolerable levels. And it raises questions about whether the low birth rates of Italy and Poland, say, really are, as some have argued, merely temporary.

The grass is greener

The list of explanations for why German fertility has not rebounded is long. Michael Teitelbaum, a demographer at the Sloan Foundation in New York ticks them off: poor child care; unusually extended higher education; inflexible labour laws; high youth unemployment; and non-economic or cultural factors. One German writer, Günter Grass, wrote a novel, “Headbirths”, in 1982, about Harm and Dörte Peters, “a model couple” who disport themselves on the beaches of Asia rather than invest time and trouble in bringing up a baby. “They keep a cat”, writes Mr Grass, “and still have no child.” The novel is subtitled “The Germans are dying out”.

With the exception of this cultural factor, none of these features is peculiar to Germany. If social and economic explanations account for persistent low fertility there, then they may well produce the same persistence elsewhere.

The reason for hoping otherwise is that the initial decline in southern and eastern Europe was drastic, and may be reversible. In the Mediterranean, demographic decline was associated with freeing young women from the constraints of traditional Catholicism, which encouraged large families. In eastern Europe, it was associated with the collapse in living standards and the ending of pro-birth policies after the fall of communism. In both regions, as such temporary factors fade, fertility rates might, in principle, be expected to rise. Indeed, they may already be stabilising in Italy and Spain.

But Germany tells you that reversing these trends can be hard. There, and elsewhere, fertility rates did not merely fall; they went below what people said they wanted. In 1979, Eurobarometer asked Europeans how many children they would like. Almost everywhere, the answer was two: the traditional two-child ideal persisted even when people were not delivering it. This may have reflected old habits of mind. Or people may really be having fewer children than they claim to want.

A recent paper* suggests how this might come about. If women postpone their first child past their mid-30s, it may be too late to have a second even if they want one (the average age of first births in most of Europe is now 30). If everyone does the same, one child becomes the norm: a one-child policy by example rather than coercion, as it were. And if women wait to start a family until they are established at work, they may end up postponing children longer than they might otherwise have chosen.

When birth rates began to fall in Europe, this was said to be a simple matter of choice. That was true, but it is possible that fertility may overshoot below what people might naturally have chosen. For many years, politicians have argued that southern Europe will catch up from its fertility decline because women, having postponed their first child, will quickly have a second and third. But the overshoot theory suggests there may be only partial recuperation. Postponement could permanently lower fertility, not just redistribute it across time.

And there is a twist. If people have fewer children than they claim to want, how they see the family may change too. Research by Tomas Sobotka of the Vienna Institute of Demography suggests that, after decades of low fertility, a quarter of young German men and a fifth of young women say they have no intention of having children and think that this is fine. When Eurobarometer repeated its poll about ideal family size in 2001, support for the two-child model had fallen everywhere.

Parts of Europe, then, may be entering a new demographic trap. People restrict family size from choice. But social, economic and cultural factors then cause this natural fertility decline to overshoot. This changes expectations, to which people respond by having even fewer children. That does not necessarily mean that birth rates will fall even more: there may yet be some natural floor. But it could mean that recovery from very low fertility rates proves to be slow or even non-existent.

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*" Low and Lowest-Low Fertility in Europe: Causes, Implications and Policy Options". By H-P Kohler, F.C. Billari and J.A Ortega. University of Pennsylvania, 2005.

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The House of Lords

A-leaping, with a vengeance

Feb 9th 2006
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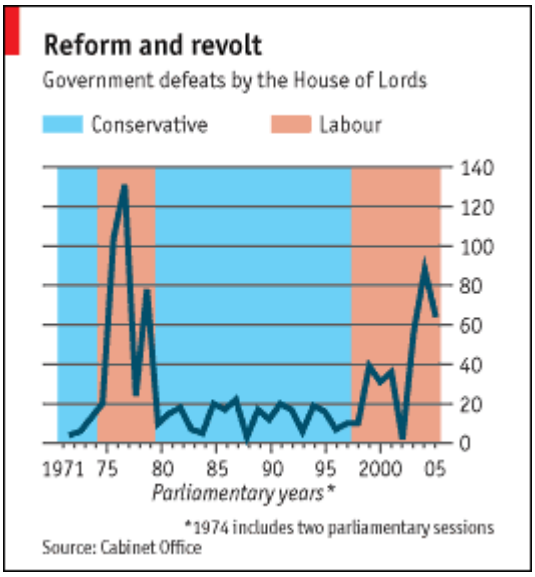
How Britain's upper chamber became so uppity

THE House of Lords runs on politeness. There is no speaker to keep order in the debating chamber, and the proposal to introduce one this June is adding frown lines to some already heavily crinkled foreheads. Members are not elected and they cannot be sacked, so they have little incentive to attack their political opponents. And the House's business is scheduled in friendly chats between the offices of (Baroness) Valerie Amos, Labour leader of the Lords, and (Lord) Thomas Strathclyde, leader of the opposition, who sit a few doors away from each other down an ornate neo-gothic corridor.



“People in the Lords don't like to talk about party politics,” says Lady Amos. Yet, for a couple of reasons, they have become much readier to confront the government (see chart), particularly over civil liberties issues. For an example, take the bill requiring Britons to carry identity cards, heavily amended by the Lords, that returns to the House of Commons next week. Why this surge of activism?

First, many of the people who sit on the red leather benches are newcomers. Almost half of them have been appointed since Labour came to power in 1997. At the same time, reforms to the Lords in 1999 that removed most of the hereditary peers have brought the total number of Lords down from about 1,300 in 1999 to 700 now. Though the reforms were dismissed by many at the time as incomplete, they have created a very different upper house. The remaining Lords are more confident, turn up regularly and are less inclined to do what the government tells them.

“Before 1999 the place was congested with people wearing thick tweed clothes,” says Anthony Quinton, an ex-Oxford don and Conservative peer. “If they saw there was a vote on the preservation of red deer in the Highlands they would come rushing down to Westminster, then disappear again when things like war or terrorism were being discussed.” Now, he says, “the Lords are no longer held back by the fear of looking absurd.”

Second, the sorts of laws proposed by government have changed. According to Philip Norton, a political scientist who sits on the Conservative benches in the Lords, this is because many are aimed at regulating the private sector, and are therefore more complex than laws on, say, criminal justice. The company law reform bill, which has 885 clauses and runs to over 500 pages, is a good example. So although there are not actually more new bills around than there were under the Tories they do tend to be longer.

In theory, the Commons is meant to look at all this stuff in detail. But in practice MPs don't have the time. Due to changes in the way parties now work (see article), MPs have to put much more energy into stroking their constituents if they want to get re-elected. There are also more exciting things for them to do in the Commons, like sitting on a select committee and grilling government ministers. As a result, the standing committees in the Commons (which are meant to scrutinise every new law) are thinly attended and skip over chunks of each bill. This has created a power vacuum that the Lords—which goes through new laws line by line and claims to sit for longer in each session than the Commons does—has happily filled.

The Lords' new status is making life harder for the government and having a big effect on lawmaking. Though Labour is now the largest party in the Lords, with 206 peers to the Conservatives' 205, it does not have a majority. There are 191 crossbenchers, many of whom are former civil servants, judges and senior military types. They tend to be socially conservative, speak only on issues where they have expertise and vote infrequently. The political balance is therefore held by the Liberal Democrats, with 74 peers. Whereas the Tories hope one day to get into government, and are wary of being obstructive in case they set a precedent that will be used against them, the Lib Dems have no such qualms, and like to argue that the Salisbury convention (whereby the Lords won't oppose bills on which the government campaigned in general elections) no longer stands.

On votes that touch civil liberties, the balance of power can be seen clearly. On ID cards, control orders, laws on glorifying terrorism and on religious hatred, an unbeatable coalition of Lib Dems, crossbenchers influenced by the judges in their midst and Tories worried about preserving ancient freedoms comes together. Though the Lords can't strike bills down—the government can ultimately get its way by forcing bills through under the Parliament Act—their alterations are often successful. Several key clauses in the religious hatred bill were drawn up in half an hour by Lord Lester, a Lib Dem peer, and are now the law of the land.

None of this is very democratic, but voters don't seem to mind. Reform of the Lords sends even politicos to sleep and has not featured prominently in Labour's last two manifestos. And in a recent poll by MORI for the Constitution Unit at University College London, 68% of respondents thought it was sometimes all right for the Lords to vote against government bills.

The danger for the House of Lords, Walter Bagehot noted in the 19th century, lies “not in assassination, but atrophy; not abolition, but decline”. Through a botched reform and a lot of prolix laws, Labour has managed to rescue it.

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Religious schools

Do as Rome does

Feb 9th 2006 | GLASGOW
From The Economist print edition

State schools for Scottish Muslims

PA

A school of their own

AT THE gates of St Albert's Roman Catholic Primary School in Pollokshields, a suburb of Glasgow, mothers swathed in black are waiting to collect their children. Most wear veils; some have even their faces covered. St Albert's is a Catholic school, with Catholic teachers, but most of its pupils are Muslim. They begin the day with the Lord's Prayer, and typically end it, late, with Arabic lessons in a local mosque. This is the exhausting routine of many Muslim children at non-Muslim schools.

Scotland, unlike England and Wales, has no Muslim schools, private or state-funded. Last year, in an effort to change this, members of Glasgow's mosques and Muslim organisations formed the Campaign for Muslim Schools. They first called for Willowbank Primary, a local non-denominational community school where 98% of the pupils are Muslim, to become Islamic. But they lost that bid because three-quarters of the places at the failing school were empty, and the local authority planned to roll a number of dicey primaries into a single big one. They then set their sights higher, aiming at St Albert's, a successful Catholic school where only 10% of the students are, in fact, Catholic.

The policy on religious schools in Scotland is broadly the same as in England and Wales, though the education system is distinct: the local authority will fund a faith school if a local community demands it. But state-funded religious schools in Scotland are virtually all Catholic. The Glasgow City Council is resisting the Muslim activists, saying it is not clear enough that local Muslims want an Islamic school. Meanwhile, it continues to fund a Catholic school for which there is almost no Catholic demand.

St Albert's is an extreme example of the faith schools system gone awry. Muslims are drawn to it by its sound academic performance. They also like its stress on morals, even though St Albert's stem from the wrong religion. But mainly the school's student body reflects the changed ethnic makeup of Pollokshields, which is home to Scotland's biggest Pakistani community. A decade or two ago, almost every business along the suburb's main high street bore a Scottish clan name. Now the street is lined with halal butchers and shops selling *salwar kameez*.

There are certainly signs that Muslims are getting keener on having their own schools. Back at St Albert's school gates, several mothers nod when Shamin Akhtar, a grandmother, says that if Catholics can have religious schools, then surely Muslims can too. In early February, a group of parents at St Albert's interrupted the school's monthly mass, withdrawing around 12 children. They had always had the right to do so but never exercised it.

Yet many Muslims seem happy enough with the present arrangements. Amanullah De Sondy, a research fellow at the Centre for the Study of Islam at Glasgow University, says the campaign does not speak for all Muslims. “Taking an isolationist approach is not the way forward,” he says. The Catholic church has a long history of running schools, while Islam has no comparable hierarchy or structures.

In England, the government proposes to bring 100 private Muslim schools into the state sector. Six—currently Britain's only state-run Muslim schools—have already made the switch. This official enthusiasm is motivated partly by a belief that Muslims are less likely to be radicalised in the heavily regulated state sector. Though the government enthuses about the “strong ethos” of a religious education, it can sometimes, alas, be a bit too potent.

In Scotland, several previous experiments with private Muslim schools have ended when local authorities closed the schools because the standards proved too low. But even if they had been successful, it seems unlikely that the Scottish government would share Westminster's enthusiasm for religious schools.

The always-difficult relations between the country's Catholics and Protestants shape attitudes. Glasgow itself has a violently polarised heritage, which is manifest today in overwhelmingly Catholic support for the city's Celtic football team and Protestant support for Rangers. Such worries prompted Scotland's first minister, Jack McConnell, to announce plans last week for pupils from religious and secular schools to be brought together for activities like drama and sport.

Many argue that all religious schools are a form of segregation, and so worsen sectarian relations. At schools like St Albert's, ironically, that was not the case. Pakistanis and whites in Pollokshields tolerate each other, but only at school did they mix much. Making St Albert's Muslim would probably put a stop to that.

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Education reform

The price of success

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From The Economist print edition

Winning the vote may mean losing school reform

RAISING standards by increasing diversity and choice lies at the heart of Tony Blair's contentious proposals to transform education. In that brave new world, popular schools are to expand or federate, poor schools to close, and new schools with religious or other sponsors to be encouraged. The aim is to nudge England's one-size-fits-all system of comprehensive state secondary education towards something like a clutch of independent non-fee-paying schools.

Or so the prime minister and his education secretary, Ruth Kelly, see it. Voters would probably agree: they repeatedly tell pollsters that they would educate their children privately if they could afford it. But 100 of the stalwarts on Labour's backbenches, many of them with links to education or local government, think otherwise. The reforms would allow more schools to select students, thus disadvantaging the poorer and dimmer among them, they claim. Local education authorities must be allowed to retain more control and initiative.

This week, Ms Kelly stopped telling opponents that they just didn't understand the proposals and started offering concessions to win them over. Defeat on other measures last week—for only the second time since Tony Blair took office—has perhaps made the government realise it must pull out all the stops to avoid losing on legislation it considers central to the New Labour legacy (see article). As *The Economist* went to press, around half of the Labour rebels seemed to have bought the new deal. Tories were muttering that the concessions had gutted the reforms they had previously pledged to support.

How significant are the compromises? Ms Kelly set them out in a six-page “letter of clarification”, dated February 6th, to Labour MP Barry Sheerman. He chairs the House of Commons select committee on education, which published a critical report on the proposals at the end of January. They range from the symbolic to the substantial. Among the symbols are a total ban on selection by interview, and a requirement that schools “act in accordance with”, rather than “have regard to”, the existing code of practice on admissions.

More substantial is a promise that local “admissions forums” will write yearly reports on how places are allocated in their areas, and have the power to complain to an impartial adjudicator if they think any school is acting unfairly. (This still falls short of the select committee's call for each school to have a binding target for the number of poorer children it must admit.)

The biggest concession is that local authorities will still be able, as now, to build and run new comprehensive schools. Under the proposals, their “powers and duties” will include kick-starting the new independent “trust schools”. But there is a world of difference between a power and a duty, and the success of the reforms—concessions or no concessions—will depend on which of these interpretations wins out.

Airport takeovers

Tilting at windsocks

Feb 9th 2006
From The Economist print edition

A Spanish bid for British airports has startled the markets

NEWS that Grupo Ferrovial, a Spanish construction company with its fingers in other businesses, is mulling over a bid for BAA, owner of Heathrow, Europe's busiest airport, sent shares in the British firm soaring on February 8th. Spanish bids for iconic British companies are no novelty: Grupo Santander bought Abbey National, a big mortgage lender, in 2004 and Telefonica acquired O2, a mobile phone company, in 2005. But many commentators happily dusted off their notes on the Spanish Armada and freshened their jingoism to oppose this one.

The bid—if it goes ahead—may well be contested. It is also likely to set back Ferrovial at least £8 billion ($14 billion), BAA's current market value. But it is not hard to see why the Spaniards are tempted. British airports have long been in private hands, and are transparently regulated. BAA itself is sensibly run and profitable. The government's golden share, which would have allowed it to block a takeover, was abolished in 2003. The owner of Heathrow, Stansted and Gatwick airports, BAA has a virtual monopoly in England's south-east.

Air travel in Britain is booming, too. The government reckons that the number of passengers will rise from 215m a year today to around 500m by 2030, and wants two new runways built—at Stansted by 2012 and later at Heathrow—to meet that increased demand. And BAA has a regulator that some airlines claim is a little too sympathetic when setting landing fees.

Ferrovial also brings qualities to the merger. It has done a respectable job overseeing Bristol's airport, which it bought part of in 2001. Passenger numbers have more than doubled since then. And Grupo Santander showed the quality of another Spanish manager this week when it unveiled Abbey National's first annual net profit in three years.

Where the bid could cause concern, however, is in its effect on BAA's balance sheet. Ferrovial is likely to have to borrow heavily to finance the deal. Standard & Poor's, a rating agency, says that it might cut BAA's credit rating if Ferrovial makes a formal offer. As if in anticipation, the cost of insuring against a default on BAA's bonds more than tripled this week.

A cut in the company's credit rating would raise its borrowing costs at an awkward time. BAA is issuing about £2 billion in debt right now. It also plans to invest almost £8 billion over seven years to pay for new capacity at Heathrow and Stansted.

Many think that BAA's plans for Stansted are over-ambitious. The low-cost airlines that use the airport talk of unnecessary extravagance, worrying that the higher landing fees needed to pay for the new runway will drive away customers. BAA has already admitted that it can't build the runway in anything like the scheduled time without a cross-subsidy from its other airports. But airlines at Heathrow and Gatwick don't want to pay for new runways for their competitors.

Higher borrowing costs would make the economics even less attractive. But abandoning Stansted, and the government's plans for more capacity, is not a palatable option. Peter Morrell, an aviation expert at Cranfield University, says that, if Ferrovial backed out of expanding Stansted, “officials might look less favourably” on BAA when landing fees are next negotiated. So Ferrovial will have to do some nifty financing to fund its proposed purchase—an altogether trickier job than crossing the English Channel.

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Housing

A plague on their houses

Feb 9th 2006 | LEEDS AND LIVERPOOL
From The Economist print edition

What to do with Victorian slums

"YOU have to use your imagination," says Elizabeth Pascoe, who has lived in Kensington, an impoverished district a mile to the east of Liverpool's city centre, for the past ten years. "This area may look grim, but the harm is superficial."

To make Kensington truly appealing, something closer to hallucination would be required. The streetscape is relentless: rank upon rank of houses pressing on to the pavements, with narrow alleys behind. Weeds apart, scarcely any greenery is to be seen. Some streets are denuded of human life, too; in the worst ones, every window has been covered with a security grille or simply bricked up. Not surprisingly, the few local shops are ailing.

Liverpool's terraced streets are a legacy of its industrial past. Similar ones shocked George Orwell, who, in "The Road to Wigan Pier", described tenements crowded with poor families and bugs. (He was surprised to find that some of them had stood for 50 or 60 years; they are now up to 120 years old.) Since Orwell's time, Liverpool has lost about half of its population, and more alluring accommodation has sprung up in the suburbs and the city centre. Why keep the old terraces?

Why indeed, says the government. The Office of the Deputy Prime Minister, a peculiar fief that covers housing, planning and local government, reckons terraced houses that cannot be cleaned up should be knocked down. It has allocated £1.2 billion to nine "pathfinder" schemes in areas where the property market is weak. In Liverpool, the plan is to demolish some 7,200 properties in the next few years, including the one belonging to Ms Pascoe.

To conservationists, and some local people, it is a horrifying prospect. Liverpool's Victorian terraced houses are not all pretty, they say, but they are a lot better than the high-rise blocks and lifeless housing estates that were inflicted on the city—and many others—in the mid-20th century. They could still make good family homes. Besides, the terraces are as much a part of Britain's history as the grand Georgian houses of London and Bath.

Much of this is hyperbole. Liverpool's terraces may be historically significant, but so is bubonic plague. Local estate agents reckon the conservationists' dream of Victorian streets thronged with respectable families is unlikely to come to pass. The lack of gardens dooms them, while the generosity of mortgage lenders means the suburbs are within reach of most buyers.

But something odd is happening in Liverpool's supposedly hopeless slums: prices are rising. Since the first quarter of 2003, the cost of the average property in England and Wales has risen by 22%. In Liverpool, prices are up by 59%, and terraced houses have soared by 101%. A two-bedroom house in an undesirable area, such as Kensington or Toxteth, can now fetch up to £70,000. A few years ago, such a property could hardly be given away.

The buyers who have driven up prices rarely have any intention of living in their properties, according to James Kersh, a Liverpool estate agent. Most are investors from London and Dublin who are looking for cheap properties to rent out. Their customers are mostly students and poor families in receipt of housing benefits.

This rush of private investment may yet stay the wrecking ball. Last year, a parliamentary committee that had been strongly in favour of demolition issued a more cautious report, saying that local authorities should be alert for signs of revival in the property market. Even if they are not, the cost of buying owners out has risen so much that cities will probably have to scale back their demolition plans.

If the market is recovering, why do so many properties stand empty? One clue is in the windows of condemned houses in Toxteth. Notices telling potential scavengers that all fixtures and fittings have been removed bear the stamp of public housing associations. They used to lodge tenants in the area, but have moved them out, partly because of the cost of bringing houses up to the standards now required of social housing. They, rather than private owners, are responsible for running down the neighbourhood. “It's a contrived decline,” says Griff Parry, a chartered surveyor.

For a sense of what might happen to cheap Victorian terraces if market forces were allowed to prevail, consider the Harehills district of Leeds. This is one of the poorest neighbourhoods in Britain, with benefit and unemployment rates more than double the Leeds average, and crime rates to match. Its Victorian terraces are, if anything, worse than Liverpool's. Many are “back-to-back”, meaning that not even an alley divides them: what appears from the front to be one house is, in fact, two.

Yet Harehills buzzes with life and commerce. The private landlords who own most of the houses will rent to anyone—asylum-seekers, poor families on benefit and groups of single men. These days, much of the demand comes from eastern European workers, who cram into tiny rooms. Harehills does not just look like a Victorian slum. By providing a pool of manual labour close to the city centre, it also functions like one.

Walk the terraced streets of a northern city, Orwell wrote, and “you think that nothing is needed except to tear down these abominations.” As Liverpool is proving, though, there are worse things than crowded slums. Rather than call down a plague on the houses, condemn the restricted property markets that prevent neighbourhoods from thriving.

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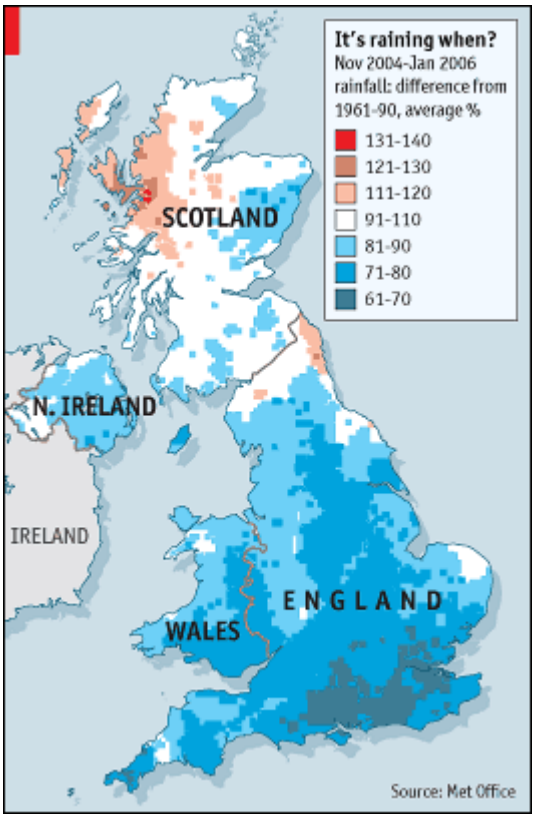
Drought

Parched

Feb 9th 2006
From The Economist print edition

A growing water shortage may change some bad habits



AT FIRST glance, the prospect of a drought in England seems about as likely as that of floods in the Sahara. But the popular perception of Britain as a uniformly dank and sodden island is misleading. The south of the country gets the same amount of rain as parts of Syria, and London is a drier city than Dallas or Istanbul. Recently, the skies have been unusually clear. Months of below-average rainfall (see map) have raised the prospect of a summer drought—the worst for decades in parts of the south-east. Elliot Morley, an environment minister, warned last week of standpipes in the streets.

Ministers (and water companies) are again encouraging everyone to use less water. Despite the sometimes unsavoury nature of the advice offered—Britons have, in the past, been encouraged to refrain from flushing toilets—such exhortations do seem to work: Thames Water, which supplies London and large parts of southern England, reckons that a publicity campaign last year caused a 4% fall in demand.

Economists argue that the best way to encourage people to be more frugal would be to price water properly. Domestic use accounts for 70% of the total, but the price that most consumers pay for water—unlike gas or electricity—bears no relation to how much they use. Instead, costs are fixed according to the value of a house, encouraging over-consumption. OFWAT, the industry economic regulator, water companies and government have all tried to persuade people to install water meters, mainly by holding out the prospect of lower bills.

But the heaviest users, who would end up paying more, have every reason not to switch. "Everyone has always regarded water as a free good," says Barbara Young, the head of the Environment Agency. Because of that, officials have been reluctant to impose meters on an unwilling population, although there are powers to do so in an emergency (something that Folkestone and Dover Water, one of the worst-affected companies, is trying to do). They are fitted automatically to new homes and can be forced on people when they move house, but take-up has been slow. OFWAT reckons that only around a quarter of homes use metered water.

There are problems on the supply side too. Many blame the water companies for not fixing leaky pipes. These are a big problem, especially in London, where parts of the infrastructure are over

150 years old. Thames Water, which supplies the capital, reckons a third of the water it pumps into the system soaks away into the ground. Part of the problem is that OFWAT, with its duty to keep prices low, is reluctant to approve the price rises needed to fund a proper replacement programme—although Thames plans to spend £1 billion over the next five years patching up and replacing the worst bits of its network.

Frustratingly, none of these worries are new. One of New Labour's first acts after taking office in 1997 was a water summit, chaired by John Prescott, the deputy prime minister, to crack down on leakage and encourage efficient use in the face of rising demand. But progress has been glacial. A voluntary water-efficiency code for housebuilders is only now out for consultation, and Mr Prescott's plans to build half a million new homes in the driest bit of the country have raised eyebrows. Many water firms plan to build new reservoirs, but that will take several years.

In the short run, not much can be done. The rune-readers at the Met Office, Britain's weather-forecasting centre, predict a cold, dry February. Even if the rains return later in the year, they will not help much: greater evaporation and thirstier plants mean that little summer rain makes it into rivers or aquifers. But if a drought persuades officials and users to change some lazy old habits, it may be no bad thing.

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Private detectives

Stop or I'll Google you

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Freelance private eyes are threatened by technology and the law

IT IS no accident that the detectives who people British crime novels and television shows are always coppers. Since the demise of the brilliant amateurs who sleuthed for their own entertainment at the beginning of the last century, diabolical poisoners with complex motives have been strictly police work. Even the business of catching adulterers in the act, once a dependable income stream for private eyes, dried up when a change to marriage law in 1973 meant the party seeking a divorce no longer needed to prove that a spouse had cheated. Compared with America, where bail bondsmen, bounty hunters and licensed private dicks all make plausible heroes, the choices for a British crime writer are limited.

Most of the work now done by private detectives involves tracing assets and finding out whether people who say they are broke really are. Large cases are handled by accountancy and legal firms, or by big security and risk consultancies such as Kroll. They hardly conform to the stereotype of the private dick.

Tommy Helsby, chairman of Kroll's European division, recalls that a few years ago the company sent an employee to speak to the board of a large bank. When the man arrived, everyone in the room burst out laughing—they had been laying bets on whether the detective would be wearing a trench coat (he wasn't). The retired policemen who make up the small firms of freelancers get called on by big companies like Kroll only for jobs that are not worth sending out a full-time employee on.

Two other changes have blunted the private sleuths' edge, according to the Association of British Investigators (ABI). First, the 1998 Data Protection Act prohibits information from being obtained through deception, fake moustaches or their digital equivalents. And second, the internet has made it harder for people to disappear. Peter Heims, who has been a private detective for 53 years (he was half an inch too short to join the police force), says he has tracked down quite a lot of people “just by typing their name into Google”. Clients may decide they can do this for themselves.

The government is about to start regulating private eyes, along with bouncers and wheel clampers. That will mean more paperwork. But trade associations like the ABI are in favour, on the grounds that licensing will raise the status of their members. Crime writers should be pleased too. The threat of being hauled before the district attorney and having his licence taken away was always hanging over Philip Marlowe, Raymond Chandler's private detective. That's one plot line that will soon travel.

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Bagehot

The rise of the untouchable MP

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In the future, governments may have to be less choosy about where they find their majorities

ONLY a little over a fortnight ago, Tony Blair described the attempt to push his school reforms through a reluctant party as a "high-wire act". Abandoning or adulterating them, he said, would undermine everything that New Labour stood for.

If the price of keeping the legislation whole was accepting Tory support, that was something he seemed willing to contemplate. While a revolt by over 80 Labour MPs would be a disaster, the prime minister hinted privately that something under 50 might be just about bearable. The message was clear. He would not object to giving some belt-and-braces reassurance on admissions policy to those who needed it, but there could be no retreat from the main thrust of the reforms.

Well, that was then. The compromise offered to the rebels this week by Ruth Kelly, the embattled education secretary, does not completely undermine the purpose of the forthcoming bill, but it does weaken it (see article). Whatever Mr Blair says, schools will have less of the independence he wanted to offer them, while the restoration of the right of local education authorities to operate as competing providers rather than neutral commissioners of services opens up a potential conflict of interest.

Mr Blair was persuaded by some of his closest allies that the "Ramsay McBlair" option (named for

Ramsay MacDonald, a Labour prime minister who stayed in office with Tory support) was not on. To allow the Tories to claim that reform had been possible only thanks to them would deal a fatal blow to his authority. It would damage not only Mr Blair, but also Gordon Brown, the chancellor. Colleagues reminded him of his duty to hand the party over to his successor in decent shape and questioned whether the fine print of school reforms that few understood was worth the agony.

Mr Blair saw it differently, but he is sensitive to the charge that because he will soon be off, he can afford to be reckless with the future health of the party. Whatever anyone else claims, as far as the prime minister is concerned, the heir to Blair is Mr Brown, bolstered by his own mandate from the electorate. Having once boasted that he had no reverse gear, Mr Blair was always likely to find one. By the lights of conventional political wisdom, he has done the only thing a responsible leader could do.

As is so often the case, conventional wisdom has a way of letting one down. While Downing Street insists that nothing more will be done to appease people who fundamentally oppose the direction laid out in the white paper, the rebels have developed a taste for negotiation. Worse still, “rebels” is a term that unites disparate groups with different agendas. Some are genuinely working for a deal, others want to inflict a defeat on Mr Blair.

Behind all this lies an important question that almost nobody (except Frank Field, a serial rebel who happens to support the school reforms) seems to be asking. Is the chronic indiscipline that is plaguing the final phase of Mr Blair's administration the inevitable consequence of habits formed during the years of big majorities and of a prime minister whose power to reward and punish is in rapid decline? Or is it that something fundamental has changed in the way MPs themselves behave?

A bit of both is the answer, but the surprising part of it is the new-found independence of MPs. Because of the professionalisation of politics—few MPs these days have major interests outside Parliament—the power of the whips to bully and cajole should have grown. For young and eager careerists that still holds true, but it leaves out a lot of MPs who are neither and, for them, the ties that used to bind have loosened.

One reason is the erosion of ideological differences over the running of the economy. Not only are tribal loyalties less strong, but the stuff of politics has changed. Issues such as ID cards, religious hatred and no-smoking zones don't split easily or obviously along party lines, opening up the possibility for shifting alliances that coalesce temporarily to thwart government.

Like everyone else, MPs are also less deferential to authority than they used to be. They are more likely to have personal opinions that differ from the party line policy and the self-confidence (or vanity) to air and act on them. That vanity is fed by the requirements of 24-hour news channels which are always ready to give a platform to the outspoken or dissident. Disloyal backbenchers have a lot more fun than dogsbody junior ministers.

Individual MPs have become more autonomous for one other big reason: the power of incumbency. They now have ample private-office budgets, which they use to dig themselves into their constituencies. With the money to do regular mail-shots, run their own websites and compile e-mail lists of constituents, MPs have the means to communicate directly with their electorate and put themselves at the heart of any local single-issue campaigns that will raise their profile. The decline of local government has also worked to their advantage. The regular surgeries which efficient MPs hold help thousands of people in the course of a parliament. And there is nothing like a grateful voter.

Majority decisions

If the past is still any guide, a new leader can restore some order to a party that has lost it. Both Jim Callaghan and John Major benefited for a time. But neither Mr Brown nor David Cameron should delude himself. However much they might wish to believe they are leading disciplined troops into battle, for a substantial number of the MPs behind them, the notion of party is an increasingly contingent one.

In future, governments without overwhelming parliamentary strength will have to be more pragmatic about where and how they find their majorities or suffer serial defeats. In turn, ideas may have to change about what constitutes political authority—carrying one's own party or a talent for constructing parliamentary coalitions on particular issues.

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Clarification: same-sex couples in Britain

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Last week's map showing the distribution of same-sex couples was compiled by Simon Duncan, of Bradford University, and Darren Smith, of Brighton University, based on data from the ONS and General Register Office for Scotland. The attribution was changed online.

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Waiting for a Wunder

Feb 9th 2006
From The Economist print edition

AP

Germany's economy is picking up, and its football fans hope for a World Cup victory this summer. But a lot more will have to come right before the country gets back on track, says Ludwig Siegele

IF YOU are visiting Germany this spring, watch out for footballs. They are everywhere, on posters, buses or entire buildings, even though the World Cup which the country is due to host this summer is still four months off. A German firm is even wrapping the giant globe atop east Berlin's landmark television tower to make it look like a football. If marketing departments had the technology, a German daily recently joked, they would project a football on to the moon.

Nor is it just marketing people who are getting excited. For the duration of the tournament most German states will liberalise shopping hours, and the government is even thinking of deploying the army around stadiums for the first time in the *Bundeswehr*'s history. Germans, it seems, are taking the World Cup extremely seriously—and not just because most of them are passionate football fans. “The last time the world paid so much attention to Germany was 16 years ago when the [Berlin] Wall came down,” says Angela Merkel, the country's new chancellor.

Germany aims to use the attention generated by this world-class event to repair its battered image. “Made in Germany” has long since lost its ring; now government and big business have teamed up in a campaign to sell the country as the “Land of Ideas”. In Berlin, where the World Cup final will be played, visitors will be treated to a “Walk of Ideas” through the capital, complete with oversized sculptures of German inventions.

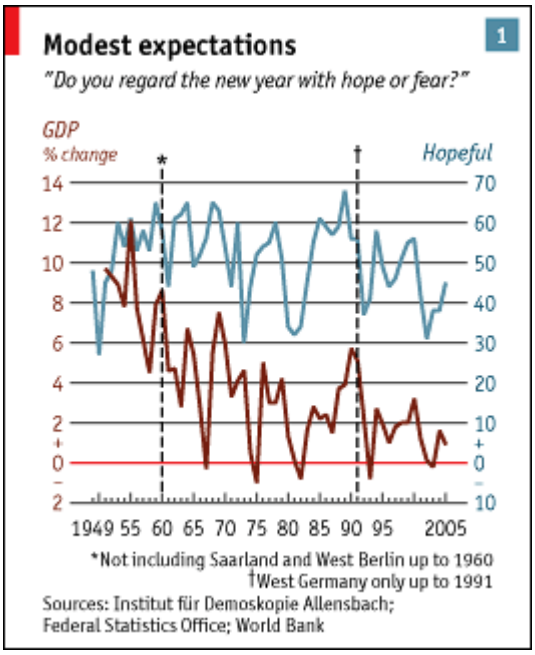
The hope is that a victory, or at least a respectable result, will help cure the collective depression

that descended on Germany when the economy started to sag at the beginning of this decade—just as winning the 1954 World Cup, held in Switzerland, helped to heal the national psyche after the war and kicked off the *Wirtschaftswunder* (the post-war economic miracle). The *Wunder von Bern*, as the unexpected victory came to be known, helped to restore Germans' battered pride in their country.

What are the chances that a *Wunder von Berlin* might kick off a similar cultural and economic rebirth? The answer depends on your perspective. Germany today is like one of those pictures where, depending on how you tilt it, you see two different images. In exports, it is already world-class. Many of its global companies have never been more competitive. With exports of nearly $1 trillion in 2005, this medium-sized country (smaller than the American state of Montana, but with 82m people) already sells more goods in the world market than any other.

Investment and domestic demand are also picking up at last, so Germany's economic outlook at home, too, has brightened. “In case you missed it, Germany is no longer the sick man of Europe,” says Elga Bartsch, an economist at Morgan Stanley, an investment bank. In 2006, she predicts, the country's economy will grow by 1.8%, the highest rate since 2000 and in line with the European average. But the labour market does not seem to have turned the corner yet: in January, unemployment before seasonal adjustment again hit 5m, or 12.1% of the workforce.

Perhaps most importantly, after years of chronic depression, the mood is much improved. According to the Allensbach Institute, a polling organisation, 45% of Germans now say that they are hopeful for 2006 (see chart 1). Business sentiment has not been so good since the new-economy bubble. Politicians, too, have changed their tune since last autumn's election that ushered in a grand coalition. The new-year address by Angela Merkel struck an upbeat note. “I want to encourage us to find out what we are capable of,” she told her fellow Germans. “I am convinced we will be surprised.”



Look at the country from a different angle, however, as this survey will do, and it becomes clear that even if it won the World Cup for the first time since 1990, it would have plenty left to do. Germany may be in better shape than France or Italy, and many other countries would love to have its problems, but that does not mean it is in robust health. Most importantly, if it does not start tackling its structural problems in earnest soon, it may find itself stuck with something its people dread: *amerikanische Verhältnisse*, or “American conditions”, code for a socially polarised society in which workers are hired and fired at an employer's whim.

The risk is that Germany's labour market, in particular, will end up “Americanised”, but without the good points of the American one, such as its openness and inclusiveness, argues Wolfgang Streeck, head of the Cologne-based Max Planck Institute for the Study of Societies. In many areas, he says, the German story has been one of “a high average and a low standard deviation”: a rich society with wealth and opportunity fairly spread, with few outliers at either end of the scale. But increasingly, he says, the story is turning into one of “a low average and an exploding standard deviation”.

If think-tanks have their numbers right, Germany has already ceased to be the “equitable middle-class society” that other social scientists have described, offering a “social elevator” for everybody.

When it comes to social justice, Germany is already doing less well than many other European countries, according to a recent study by BerlinPolis. For instance, the risk of poverty has greatly increased in recent years, especially for the young. About a fifth of Germans under 16 now live in households with incomes below the poverty-risk threshold.

The fault does not lie primarily with globalisation and the “locusts”, as many Germans have taken to calling foreign investors. Rather, it is the very systems meant to guarantee a well-balanced society, along with the attempts to preserve them, that are increasingly dividing German society. Those systems now serve vested interests, driving a wedge between well-provided-for insiders and marginalised outsiders.

This survey will describe the ways in which Germany's institutions have slid from virtue to vice: in politics, in the labour market, in education, in competition policy and elsewhere. It is not that the country has not tried to change. But most of these changes have been designed to optimise existing systems rather than change them fundamentally.

This survey will journey through a country struggling with change, passing through Berlin, Stuttgart, Nuremberg, Cologne and Frankfurt. It will note that in some ways the future has already arrived: it is simply distributed unevenly. Much of it can be found in places where you might least expect it—such as in the eastern city of Jena, where the journey ends.

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In a bind

Feb 9th 2006
From The Economist print edition

EPA

Merkel advocates small steps

The grand coalition will need quite a lot of luck to make Germany work better

LAST summer Sir Peter Torry, Britain's ambassador to Berlin, asked a group of journalists which new German films he should watch. They came up with a list of titles that pretty much summed up what had been on Germany's mind in recent years: “Ways to Improve the World”, “The Fat Years Are Over” and “The Great Depression”.

Germans have never been wildly cheery (see chart 2); explanations for the national malaise include the weather, Protestantism, philosophy and the Nazi era. But in recent years self-criticism had been veering towards self-flagellation. German self-esteem had been badly hurt by the slide from the top of the economic and social league. The feeling was fed by the media and by professional doomsayers.

Yet in the months before last September's election, people started to get fed up with despondency and started buying books that made them feel better about themselves. One of the more interesting was “Foreigners See It Differently” by Susan Neiman, an American philosopher and director of the Einstein Forum in Potsdam. She pointed to Germany's low crime rate, its admirable cultural infrastructure and its good public transport system and argued that in their self-pity, Germans tend to forget that their country is in better shape than most. What they badly need is some American can-do optimism.

Since the new government was installed in November, the mood has much improved. Polls show that people are more willing to accept change. The political constellation also appears much more favourable for reforms: the grand coalition has a two-thirds majority in the Bundestag, Germany's lower house, and also controls the Bundesrat, the upper house, albeit by a much smaller margin. Perhaps for the first time since unification, there seems to be a real opportunity for politicians to prove that they can move fast and far enough.

In the early 1980s, when America and Britain were in crisis, Germany was praised as a clockwork mechanism whose cogs meshed perfectly—rather like those well-engineered German machines that never seem to break down. The “German model”, although to a large extent the result of historical accident, performed brilliantly at a time when high-quality industrial products were much in demand and the pace of economic change was still relatively slow.

The political system, in particular, had proved highly effective at delivering smooth, incremental change. It was a machine with two big wheels in the middle, the Christian Democrats (CDU) and the Social Democrats (SPD), and a small one running in coalition with either one of the larger two, the Free Democrats (FDP). Faster-turning wheels to the right and to the left never really got anywhere, partly because of Germany's experience with fascism and partly because of communist East Germany next door. Even the Greens did not disturb this arrangement much, because they quickly became simply a left-leaning alternative to the FDP.

The machine had powerful safeguards built in to keep it on track, particularly the *Länder*, Germany's constituent states. Via the Bundesrat, their representative body in Berlin, the *Länder* have a say in many key areas. The “financial constitution”, a cobweb of tax-revenue equalisation and joint public spending by the different levels of government, has allowed wealth to be spread pretty evenly across the nation.

Yet it is Germany's federal structure that has increasingly jammed up the country's political machine. Through legal changes and judgments by the Federal Constitutional Court, the *Länder* have accumulated too many veto rights, offering many points of leverage for interest groups—and making most reform exceedingly difficult. The financial constitution, for its part, has come to discourage the states from trying new solutions.

German unification in 1990, welcome though it was, probably made reform even harder. To speed up eastern Germany's integration, vast amounts of money were pumped in (a total of €1.3 trilllion to date), and any plans for change were put on hold. Even now, the eastern *Länder* receive transfers from the western ones of €80 billion a year, or 4% of Germany's GDP.

Unification gave Helmut Kohl, the chancellor of the day, a new lease of political life, and from the mid-1990s he did try to introduce some structural reforms. But tripartite talks with trade unions and employers proved fruitless, and reforms were blocked by the SPD, which at the time controlled the Bundesrat.

Mr Kohl's successor, Gerhard Schröder, found himself in a similar bind after only one term of office. Like Mr Kohl, he tried tripartite talks. When those failed, he set up commissions to draw up

reform proposals, and pushed them through as his “Agenda 2010”. To the dismay of his internal opposition, the SPD's left, he operated a de facto grand coalition with the external opposition, the CDU, which had taken control of the upper house.

Predictably, the result of all this manoeuvring was a bit of a mess. Agenda 2010 tried to move in the right direction, but much of it consisted of short-term fiscal repairs mixed with political compromise. Even so, it cost the SPD one regional election after another. When the party lost power in its traditional fief of North Rhine-Westphalia in May last year, Mr Schröder realised that his method had run its course and sought new federal elections—hoping, some say, that the result would be an official grand coalition.

New brooms

Now that it has come to pass, will this new left-right alliance, led by Angela Merkel, make a better fist of resolving Germany's problems? It has certainly brought a change in style. Mr Schröder trusted his instincts and was a master at taking people by surprise. Ms Merkel, by contrast, is utterly methodical. A doctor of physics, she seems to view political challenges as a scientific experiment in which she allows the different forces to slug it out before intervening. This may be a useful qualification for heading a grand coalition, a configuration last tried, with limited success, in the late 1960s. In theory at least, she should manage to keep the two big parties together: both of them now need to be on their best behaviour, or run the risk of being punished at the next election.

Already, the thrust of German politics has changed perceptibly since the coalition was formed in November. Ms Merkel, who during the election campaign advocated rapid reforms, now talks about the need for “small steps”. At times she sounds almost like a Social Democrat. Journalists have started to complain that there are not enough leaks or backstabbing, and lobbyists are finding it harder to get traction.

Yet for the new government to make a difference, it needs to win three gambles. The first is to reduce the budget deficit without killing the incipient recovery. This year it intends to spend a bit more, even if that will cause Germany once again to exceed the limit of 3% of GDP set by the EU's stability pact. Next year, however, it plans to cut subsidies and other spending and, above all, increase the value-added tax rate from 16% to 19%.

The weaker the recovery, the more difficult it will be for Ms Merkel to win the second bet: getting the coalition partners to agree to sustainable solutions to at least some of the country's structural problems. The test case will be the financing of health care, which the government intends to tackle later this year. With medical spending expected to rise steeply because of demographic factors as well as technological progress, the big question is how to keep health-care contributions from becoming a prohibitive tax on labour.

The third wager is that the *Länder* will do their bit to improve the way Germany is run. They have already agreed to a reform of the federal structure, which will reduce their veto rights over federal affairs, in return for gaining more local powers, notably over education. But it is quite another question whether the states will go along with a reform of Germany's “financial constitution”. And Ms Merkel's rivals within the CDU, most of them state premiers, may want to keep her from becoming too successful.

Much, therefore, can still go wrong on the way to further reform. And even if Ms Merkel's “small steps” lead somewhere, they may not solve some of the biggest problems—such as education, the subject of the next article.

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Wasting brains

Feb 9th 2006
From The Economist print edition

Germany's school system fails to make the most of the country's human capital

Alamy

Wait till you see the homework

WHAT is the best way of measuring improvements in a school system? Grades, perhaps; or the proportion of students getting a high-school diploma. In Germany, though, it may be the number of cafeterias in schools. Hundreds are being built in a nationwide effort to create the infrastructure that will allow schools to operate all day so that children can spend more time learning, instead of being sent home in time for a hot lunch.

Yet this construction activity also shows how far Germany still has to go to modernise its school system, and to turn it into an efficient engine for promoting talent and brains. German schools are superb at separating insiders from outsiders. But in so doing, they squander the human capital that the country needs to prosper.

"In Germany, there is nothing more controversial than education," says Helmut Rau, minister of education and cultural affairs in the state of Baden-Württemberg. He has just been grilled in the state parliament in Stuttgart over his government's school reforms. Parents have complained that even younger pupils are now required to stay in school for several afternoons a week and are given lots of homework on top. This is because Baden-Württemberg has just become the first western state to cut the period of secondary schooling from nine to eight years (in the east, eight years has always been the norm). "It's just getting too much," exclaims one MP who is also a mother.

To understand such complaints, you need to know a bit about the history of German education. Like other European countries, Germany from the Middle Ages developed a school system based on class. But whereas most other European countries have since moved on to more inclusive systems, Germany has essentially stuck to a three-tier structure: the *Hauptschule* (for students who hope to go on to an apprenticeship), the *Realschule* (whose graduates typically take middling white-collar jobs) and the *Gymnasium* (awarding the *Abitur* that admits the holder to university). Only at the *Grundschule* (elementary school) are pupils from all ability groups taught together.

After the second world war the Allies tried to impose a unified school system on the country, but the *Länder* refused to play. They have always seen education as a question of local power, which explains why state governments ended up with such wide-ranging responsibilities for it. Yet in practice this has meant that German education combines the worst of both centralisation and devolution. To comply with the constitutional requirement for "equality in living conditions", the *Länder* must agree on some common rules, which has proved a barrier to reform: the body created for that purpose, the Standing Conference of the Ministers of Education and Cultural Affairs, has to agree unanimously on any change.

Another barrier to reform is ideology. Education has always been a battleground of ideas, particularly since the first *Gesamtschulen* (comprehensive schools) opened in the mid-1960s. Many on the left saw this type of school as a silver bullet to ensure equal opportunities for all. The right, for its part, made “Save the *Gymnasium*” its rallying cry. It seems to have won: only about 700 out of over 19,000 secondary schools are now *Gesamtschulen.*

Crucially, the main beneficiaries of the present system are determined to resist change. “This is about keeping many away from society's feeding troughs,” says Wilfried Bos, head of the Institute for School Development Research in Dortmund. And indeed Germany's school system is brilliant at what it was built for: selection. In most *Länder*, following four years at elementary school, pupils are streamed into one of the three kinds of secondary school. A pupil who happens to be a slow learner or whose family does not particularly value education will find it very hard to move up from a less demanding school to a *Gymnasium*. By contrast, those who cannot keep up with the pace at the *Gymnasium* soon find themselves demoted.

Add the facts that teachers' unions wield lots of power and that schools are overregulated and underfunded, and it is easy to understand why German schools are inefficient and often ineffective. There are hundreds of curriculums that describe what teachers should teach, but few mechanisms to ensure that the children have actually taken it in. Nor is much official attention given to individual support, whether for weaker or for exceptionally bright students. Instead, parents spend vast sums on supplementary private tutoring, often provided by teachers in their spare time.

Life after PISA

Despite all this, Germans long considered their country's school system among the best in the world. What persuaded them otherwise was PISA, the OECD's Programme for International Student Assessment, which compares educational achievement in different countries. The first results in 2001 came as a nasty surprise: Germany ranked only 21st in reading skills and 20th in maths and science among 31 countries assessed. “The loss of reputation became a powerful force for change,” says Dieter Lenzen, president of Berlin's Free University.

The “PISA shock”, as it came to be known, did indeed trigger much reform activity, but all within the existing system. Western *Länder* began shortening the *Gymnasium* course, clearing out their curriculums and controlling their schools' output through state-wide exams. Their standing conference is now working on drawing up nationwide educational standards. And the federal government has started a *euro*4 billion programme to create *Ganztagsschulen*, or full-time schools.

The state of Baden-Württemberg is generally seen as a model in education, partly because its school system provides for some upward mobility and partly because it started out on reforms even before PISA. It was the first west German state to shorten the *Gymnasium* course by a year. But the core of the reforms, says Mr Rau, the education minister, are the new curriculums, which give each school a fair amount of autonomy. “It has always been an illusion to think that we are able to tell schools exactly what to do,” says Mr Rau.

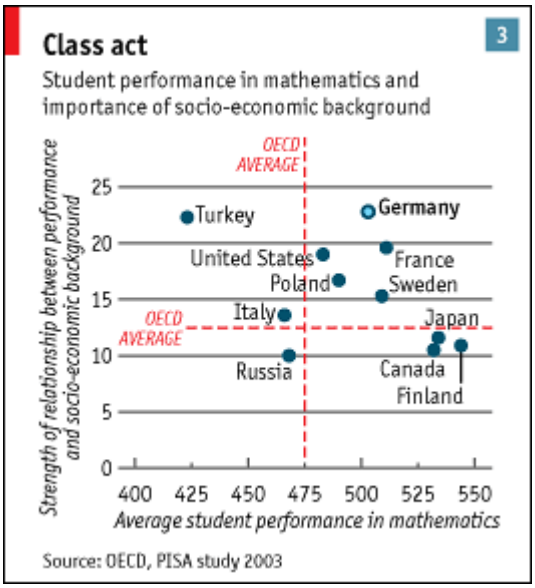
Since the reform, the schools themselves can decide how to fill a third of the lessons. The character of the curriculums has changed as well. In the past, for instance, English teachers in 10th grade were told how many words and which grammatical rules they had to teach their students and exactly what they should tell them about America. Now the curriculums are all about “competencies”, general skills that students are expected to master. To make sure they do, they have to take state-wide tests every other year.

Some schools are already learning to make use of their new-found autonomy. At the Geschwister-Scholl-Gymnasium in Sillenbuch, a suburb of Stuttgart, the new curriculum has led to a series of internal reforms, says Irmgard Brendgen, the school's principal. Subject teachers, for instance, have had to start co-operating with each other and draw up guidelines for their area of expertise. Because school days are now much longer, the school decided to do away with the 45-minute lessons that are customary in Germany and replace them with periods of 90 minutes. This, in turn, set off new thinking about the best teaching methods for such a period. “It has been a demanding, but also a very positive process,” says Ms Brendgen.

Yet elsewhere things have not gone so smoothly. Many *Gymnasien* in Baden-Württemberg seem to be stuck in their old ways: they do what they have always done, and just cram the same syllabus into a shorter period of time—hence the protests from parents. Yet critics also blame the plethora of new tests: schools will now teach to the tests instead of taking advantage of their greater independence.

At any rate, such reforms will not resolve the other big problem of Germany's education system: social segregation. Again, it has been PISA that has forced the country to face reality. When another round of results made headlines in November last year, German students' performance turned out somewhat better than the first time, but a different measure attracted more attention: a 15-year-old's school record depended more heavily on socio-economic background than in any other big industrial country (see chart 3). In Germany, the child of a professor is four times more likely to go to a *Gymnasium* than the equally bright child of a manual worker. The chances of an immigrant's child will be even more skewed.

Look at almost any *Hauptschule*, and you will soon discover that schools are not created equal either. The Pestalozzischule in Rohr, another suburb of Stuttgart, is certainly one of the better-run, and Maria Pfadt, the principal, goes to great lengths to give her students a good start. She works closely with local businesses, which regularly give presentations at the school (and one recently donated €250,000 for a building to house such events). She even gives classes in manners, and takes students to the opera to reduce social barriers.



Yet if the Geschwister-Scholl-Gymnasium comes across as a secondhand Mercedes in good repair, the Pestalozzischule is more like a beat-up Volkswagen. Its teachers give more lessons to larger classes but are paid less. More than a third of its students are immigrants' children, compared with 7% at the *Gymnasium* on the other side of Stuttgart (although, to be fair, fewer of them live in its catchment area). In the centres of big cities, the children of immigrants often make up the majority of a class, and sometimes all of it.

Even more disappointing for the students who attend a *Hauptschule*, Germany's famed “dual model” for apprentices (who spend half their time on the shop-floor and the other half in a vocational school) is no longer the social elevator it once was. Many would-be apprentices are crowded out by graduates of grander schools. And the maths demanded in some apprenticeships can be far too hard for somebody with only basic schooling. Besides, many German firms simply no longer take in apprentices. All this explains why more than half of vocational-school students no longer do a classic apprenticeship but enrol in some other professional programme.

At stake are not just equal opportunities, but the future prospects of the German economy. “The German education system is wasting valuable potential,” says Andreas Schleicher, a co-ordinator of PISA research at the OECD. He has become something of a *persona non grata* among Germany's education establishment, perhaps because he dares to criticise his own country. Mr Schleicher thinks that in its education policy Germany needs to become more like Finland, which twice topped the PISA charts for literacy. For instance, it could start teaching children in nursery school rather than simply letting them play, stop selecting students for different types of schools so young, and create a culture of individual support.

In the long run, Germany may have no choice but to do away with its three-tier school system. Such attempts have failed before, but two new forces are now at work. One is demography: as the number of pupils drops rapidly, having just one, comprehensive, kind of school may be more efficient than maintaining three.

The other force is business, which cannot thrive without well-educated employees. It was a lobbying organisation for Bavarian business, the Vereinigung der Bayerischen Wirtschaft, that in 2003 published the most comprehensive study so far on how to reform Germany's education system. According to the PISA study, Bavaria has the best students in the country but the smallest proportion of those awarded the *Abitur*, which means that it has to import them from other *Länder*. In fact, in Germany as a whole the share of students who qualify for admission to university is low by international standards: the current number is only 35%, compared with an OECD average of 56%.

Moreover, for Mr Lenzen, the Free University's president who co-ordinated the Bavarian study, reforming Germany's schools will not be sufficient. He reckons that its nursery schools, universities and professional training also lag behind, and that the country needs to rethink its entire educational system to produce enough brains for its economy to prosper.

Yet the creation of outsiders is not the sole prerogative of Germany's school system. Social divisions are widened and deepened further by the labour market, the subject of the next article.

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Squaring the circle

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Despite a raft of reforms, Germany's labour market still excludes far too many people

Reuters

New, improved job shop

HEADQUARTERS can reveal much about an organisation. The Bundesagentur für Arbeit (BA), Germany's federal employment agency, based in Nuremberg, is a case in point: if the star-shaped formation of 1960s high-rise buildings were a housing estate, it would have been demolished long ago. Inside, the building is pure Kafka: long grey corridors that meet at strange angles, causing visitors to get lost.

Yet open a door on the 8th floor, and you suddenly arrive in the 21st century. The brightly lit room is filled with bulletin boards covered with hundreds of charts, most of them coloured in some combination of red, yellow and green. “We are using traffic-light logic to spot problems quickly”, says Dieter Vollkommer, the former head of the BA's reform team.

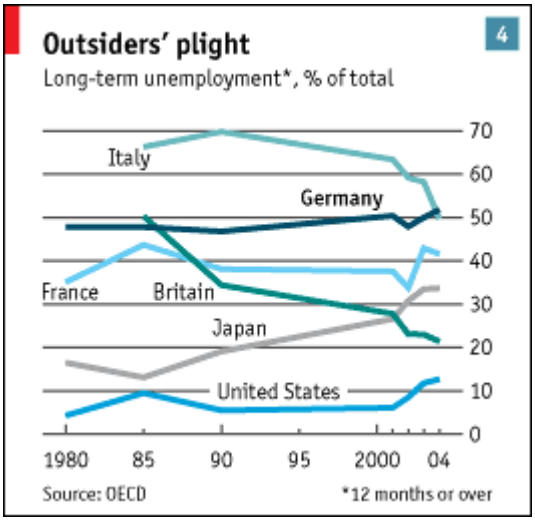
This office is the war room for what may be the most ambitious reorganisation ever attempted in Germany: turning the BA, the country's largest bureaucracy with more than 90,000 employees, into a “customer-oriented service provider”, as Mr Vollkommer puts it. The BA has put much effort into turning the dreaded Arbeitsämter—its local offices where jobseekers used to take a number and often wait for hours—into “customer centres”, complete with crowd control and consultation cubicles.

The BA is a sure sign of Germany's will to reform: it is the most visible of a plethora of labour-market reforms that the government has introduced in the past two years. But there are doubts that it can really help Germany's new outsiders, the growing army of the long-term unemployed, who now account for more than half of Germany's jobless (see chart 4).

If Germany's education system was built specifically to protect insiders, its labour-market was meant to be all-inclusive. It managed well until the early 1970s, when the first oil crisis caused unemployment to rise. So the government sent hundreds of thousands of workers into early retirement, and trade unions pressurised employers into cutting working hours to 35 per week, mostly at the same pay as before, in return for relative industrial peace.

Wages were often set by “national peak-level bargaining”: the IG Metall union, the biggest and strongest of them all, would negotiate a pay rise in one of its strongholds, which would then be adopted by unions

and employers in other sectors. At the same time, wages at the lower end of the scale tended to rise disproportionately fast, making unskilled labour increasingly unattractive to employ.



The effect on labour costs was magnified by the way the country finances its welfare state: through a payroll tax with matching contributions from individuals and employers. Unemployment and early-retirement programmes pushed up these contributions, and the cost of labour with them. No wonder that the country keeps losing full-time jobs and their attendant social-security contributions. Contributions now add up to over 40% of gross income, compared with 27.6% in 1970.

Unification aggravated this vicious circle. Much of the cost of integrating the former East Germany was piled on to the social-security systems because it was politically easier than raising taxes. Worse, German unions and employers' associations, both dominated by westerners, quickly agreed to raise wages in the east close to western levels. The idea was to dissuade skilled easterners from moving to the west, but in effect it priced many low-skilled easterners out of the market.

Add the de facto minimum wage set by welfare benefits, along with strong protection against dismissal, and it is easy to see why Denis Snower, president of the Kiel Institute for the World Economy, views Germany as a perfect example of his “insider-outsider theory”. It turns on the concept of labour-turnover costs—in essence, all the costs associated with firing an employee and hiring a new one. The higher these rise, the lower the probability that they will actually be incurred—which is why the people in jobs, the insiders, have an interest in keeping them high.

There are cultural reasons, too, why low-paid services in particular, the main job-creation machine in other countries, are underdeveloped. Many Germans dislike the idea of working in services, thinking them demeaning. Women, who are still underrepresented in the workforce, tend to do their own housework rather than outsource it, and many men are do-it-yourself enthusiasts.

There is little doubt that long-term unemployment would have caused considerably more political uproar had the Federal Employment Agency not been there to smooth things over. Originally a combination of an insurance company and an employment agency, the BA has evolved into the organisation that looks after Germany's growing army of outsiders. In 2001, at its peak, it spent over two-fifths of its budget of €52 billion on so-called “active labour-market policies”, code for all kinds of training schemes and job-creation programmes.

The scattercash approach

The shocking fact is not that so much money was spent, but that most of it was wasted. The measures rarely helped the unemployed to find real jobs. Instead, it was unions and employers' associations that reaped most of the benefits. Billions flowed into huge training firms operated by both these groups. Critics point out that representatives of unions and employers in effect controlled the BA's federal and regional boards.

It was not without irony, then, that a scandal at the BA became the “PISA shock” that rattled Germany's labour market. In early 2002, it emerged that some agency departments had routinely faked job-placement figures. As it happened, the chancellor, Gerhard Schröder, badly needed a theme for the forthcoming election campaign. He asked Peter Hartz, then the personnel chief at

Volkswagen, to head a commission to propose reforms.

Most of those proposals became part of Mr Schröder's reform package, Agenda 2010, and were implemented through a series of “Hartz” laws. Their purpose was threefold: to make the labour market more flexible by reducing job protection and lowering social-security contributions for certain part-time jobs (“mini-jobs”); to reform the Federal Employment Agency and equip it with better tools (for instance, the “Ich-AG”, or “Me-company”); and to encourage the long-term unemployed to look for work by introducing a new flat-rate benefit (“Hartz IV”).

All these reforms called for some new faces. Traditionally, the BA had been run by elderly politicians with expertise in social-security issues, such as Bernhard Jagoda, who had to resign after the job-placement scandal. The current president, Frank-Jürgen Weise, comes from a very different background: a former soldier, he co-founded a logistics firm and is an experienced financial controller. It may not be obvious, but this is exactly the right set of skills for the job.

When Mr Weise joined the BA as finance chief in 2002, he did not like what he found: in the absence of reliable data, the agency did not really know what it was doing. In particular, it had no idea whether the billions spent on retraining had any lasting effect. Just as with Germany's education system, it was the input that got the attention, not the output.

Mr Weise's most important task has been to create transparency. Training programmes are now evaluated and procured via central calls for tender, creating a real market. Local agencies operating in similar labour markets are competing with each other, and their performance indicators are compared every month. If an agency regularly falls short, heads may roll, but the main idea is to ensure that best practice spreads throughout the organisation.

The BA's new president already has some results to show for his efforts. Partly thanks to his cost-cutting, the government is now considering reducing the contribution to the unemployment-insurance scheme, currently 6.5% of gross income, by two percentage points next January. But Mr Weise knows that this will not be enough: unless he turns the BA into a highly efficient tool for policymakers, its enemies, who want to dismantle and privatise the bureaucratic behemoth, might yet have their way.

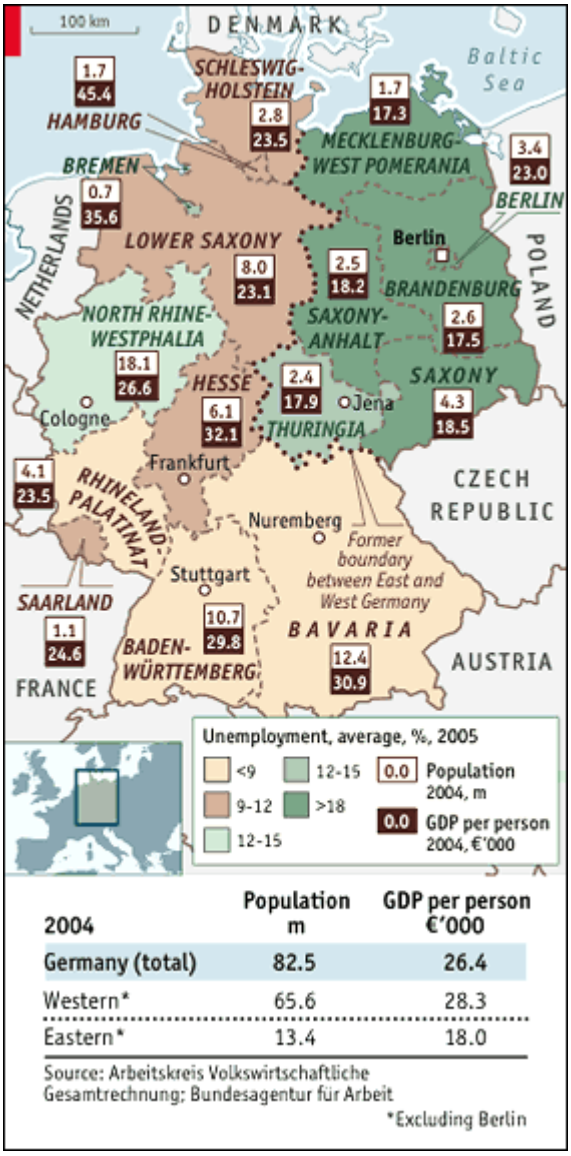
A visit to the local employment agency in Nuremberg's city centre reveals how much has changed, but also how much more needs to be done. The long queues have gone. The rule in the “entrance zone” is that it should take no more than 30 seconds to direct “customers”. If they are newly unemployed, they have to fill in a lengthy questionnaire. If they have an appointment, they can go straight upstairs.

Yet the biggest changes are less visible. “We are now acting like a real company and are no longer engaging in much social policy,” says Gisela Scherer, one of the agency's bosses. Costly long-term re-training schemes have been replaced by short internship-like programmes. And if an unemployed person is hard to place, the agency does not invest a lot of effort, explains Ms Scherer: he or she will get unemployment benefit for a year and “then be better taken care of downstairs”.

“Downstairs” is where the local “Arge” has set up shop. This is short for *Arbeitsgemeinschaft*, or working group, but it is more than that. The Arge is a new type of organisation, set up in each German city or county to look after the long-term unemployed who receive the new flat-rate benefit under the Hartz IV law. In a way, Germany has outsourced all its outsiders to the Argen (it is unfortunate that “arg” also happens to mean “bad” in German).

The big question is whether these bodies will do a better job than the BA did. Their first task is to vet applicants for the new benefit, which is means-tested and paid only to those who are seriously

seeking work. They are still sorting out their bureaucratic problems, so they have not had much time to spend on their second main job: to provide support for their clients.



2004	Population m	GDP per person €'000
Germany (total)	82.5	26.4
Western*	65.6	28.3
Eastern*	13.4	18.0

Source: Arbeitskreis Volkswirtschaftliche Gesamtrechnung; Bundesagentur für Arbeit

*Excluding Berlin

What is already clear is that Hartz IV got its incentives entirely wrong. The state calculates the benefit on the basis of a *Bedarfsgemeinschaft*, an impossible-to-translate term which broadly speaking means the household in which the jobless person lives. A single person in west Germany gets €345 a month(€331 in the east) plus health insurance, rent and utilities paid for, which makes it attractive for jobless young people, for instance, to move out of their parents' home. Policymakers had expected 2.6m *Bedarfsgemeinschaften*, but are now faced with as many as 3.7m.

Yet for all the expense, reorganising an employment agency and introducing a new benefit does not create any extra jobs, says Stephan Doll, the boss of the Nuremberg section of the Deutsche Gewerkschaftsbund, the umbrella organisation for Germany's unions. He speaks from experience: unemployment in the city is about one percentage point above the national average.

“All the labour-market reforms were no more than empty promises”, says Mr Doll, echoing the prevailing German mood. Many now argue that instead of introducing further reforms, the

government should raise wages and start spending again—on infrastructure and education, and on developing the local economy. As it happens, the new government has recently announced a programme under which €25 billion will be spent on such measures over the next four years.

Yet the next round of labour-market reforms also seems to be under way. During the election campaign last year, the parties outbid each other with proposals. The Social Democrats wanted to introduce minimum wages to stop wage dumping by east Europeans. The Christian Democrats were keen to weaken union power and job protection. In their grand-coalition agreement, the two parties made hiring and firing a little easier: new employees will in future have to wait for two years rather than the current six months before their job tenure is secure. Now the coalition is toying with something called *Kombilohn*, a combination of a low market wage plus a government subsidy.

Ulrich Walwei, deputy director of the Institute for Employment Research, the BA's think-tank, is sceptical about this flood of new ideas. First, he says, the earlier reforms have to be properly evaluated. Mini-jobs, with a maximum pay of €400 a month and social-security contributions of only 25%, have certainly shown that lowering the cost of low-skilled work can create jobs: there are now nearly 7m of them. But outsiders do not seem to have benefited, and it is unclear whether these jobs have simply replaced full-time ones.

Weakening or even doing away with job protection, from which most insiders still benefit despite many changes at the margins, is certainly no silver bullet, says Mr Walwei; nor is the *Kombilohn*. For such a model to work, the de facto minimum wage would have to come down significantly, which would be tricky in the current climate. A better solution, he says, might be to cut social-security contributions for all low-wage jobs.

Whatever Germany does, it must reduce its army of outsiders, argues Mr Walwei, or it will be in trouble as the country's population starts to shrink. Contrary to conventional wisdom, he thinks that a smaller workforce is unlikely to solve the unemployment problem if the job-seekers do not match the specifications of the jobs on offer. “If we don't get supply and demand to match at that point, our economic dynamism will go down the tubes.”

But a sclerotic labour market is not the only reason why unemployment remains high. Over-regulated markets are just as much to blame, as the next article will demonstrate.

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Land of cliques

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dpa

Spot the wheeling-dealing

Corporatism and lack of competition are the enemies of an efficient economy

CITY tours are one of Cologne's strong points. But if you want to get beyond the cathedral, the Romanesque churches and the old city, ask Werner Rügemer, a journalist. He will take you on a tour of the landmarks of the *Kölsche Klüngel*, or Cologne Clique, a particular form of wheeling and dealing for which the city is famous across the country.

Mr Rügemer may soon want to add some new attractions to his tour. A couple of big local property deals—an event forum called Kölnarena and an addition to the city's exhibition centre—have caused a stir recently. The exhibition centre, say critics, was approved without the usual official EU-wide call for bids—though the city treasurer explains that this type of contract does not require a bidding process, and that Ernst & Young, a firm of accountants, was asked to check out the market.

Still, the general impression is that Cologne's politicians have not tried very hard to make their business transparent—and nobody really seems to care. “It is considered folklore—just like the carnival here,” says Mr Rügemer.

Cologne provides a striking illustration of the way that in some parts of Germany's economy, rent-seeking seems to be more important than wealth-creation. In a forthcoming book about reform in rich countries, Adam Posen of the Institute for International Economics, a think-tank based in Washington, DC, argues that this keeps prices high and stops the country's economy from becoming more efficient.

“Nothing much has changed. If anything, it has got worse,” says Ute Scheuch, a retired journalist. More than a decade ago, she and her husband, Erwin Scheuch, a sociology professor at Cologne University, published a report on the Kölscher Klüngel. It contained few new revelations, but for the first time it analysed the rules of the game. What the authors found was both amusing and alarming. Not only were the local organisations of both the Christian Democrats and the Social

Democrats controlled by cliques that handed out offices, but in Cologne such deals were actually put in writing.

The way things are done around here

After such publicity, you would expect the participants in these power games to be more careful. But since then it has emerged that fat bribes were paid in the 1990s for the business of building an oversized refuse incineration plant near Cologne. The case is still going through the courts.

Now controversy has arisen over Esch, an investment fund run by Cologne-based Sal. Oppenheim, Europe's largest private bank, over some of the big local property deals the fund has got involved in. Esch has been raising money from wealthy people, of which Cologne has a good number. That seems unsurprising enough. More surprisingly, the fund is run by a former city manager, who took the job after doing a deal with Esch. The fund also bagged, on favourable terms, two of the city's biggest deals, which were rushed through the city council without leaving time for thorough scrutiny by councillors.

One of them is now under investigation by the public prosecutor. It concerns a project that started in 2003 when Cologne decided to add some new halls to its exhibition centre so a big TV broadcaster could move into some of the older ones. The city argued that unless the project went ahead quickly, the TV station would move away from Cologne, causing tax and job losses. The Esch fund bought the land, put up the buildings and rented them out to the city. Neither the city nor the fund will say how much the project cost, arguing that to do so would be unusual business practice.

When a TV programme last summer claimed that the city could have got a much better deal, the public prosecutor's office in Cologne started to look into it; and the local Greens, who were in a coalition with the Christian Democrats when the deal was approved, are having second thoughts. “We didn't know that the Esch fund was involved,” says Barbara Moritz, their leader. “We were told that the project was for the good of the city, but it seems it was more for the good of the fund.”

The problem, in Cologne and elsewhere, is that local councillors are often unpaid and have no one to help them, so they depend on the information they get from the city administration. The local papers did not take much of an interest in the property deal until the TV programme drew attention to it. The publisher of Cologne's three big dailies is also an acknowledged investor in the Esch fund.

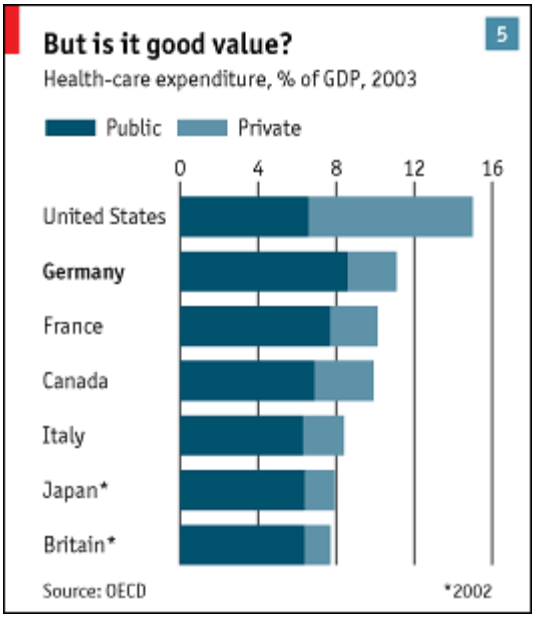
Yet in general, things have improved somewhat, says Hansjörg Elshorst, chairman of the German section of Transparency International, an anti-corruption group. He puts this down to recent legislation to keep civil servants and public officials honest. However, he says, in private firms corruption remains widespread.

At times of rapid growth, lack of accountability did not seem to do much harm; indeed it helped to speed up decision-making. Yet today each euro wasted means a euro less for social services, says Karl Lauterbach, an economist at Cologne University. The city is the most indebted in the state of North Rhine-Westphalia and has long failed to invest enough.

Last September Mr Lauterbach, a Social Democrat, won a seat in the federal parliament. Yet he is an example of a rare species called *Quereinsteiger*, somebody entering politics after a career in a different field: he originally studied medicine and economics at Harvard. And he has

no intention of becoming part of the *Klüngel*.

In any case, Mr Lauterbach would not fit in. His academic speciality is Germany's health-care system, and to him the health-care industry is proof that German-style corporatism can be at least as costly as backroom deals. Just like education, he says, it is a system that protects privileges without adding any value: “It is not only inefficient, but also creates injustice.”



Unhealthy influence

Seen from outside, some elements of Germany's health-care system indeed appear counterproductive. For instance, there are the *Kassenärztliche Vereinigungen*, regional doctors' associations that negotiate fees with the public-health insurers and then distribute the money. They are also meant to ensure that there are enough doctors to go round everywhere, but they seem simply to provide an arena for in-fighting.

Nor does the split in the health-insurance market between public and private firms make obvious sense. Contributions to a public health-insurance scheme are compulsory for everybody below a certain income limit, currently about €47,000 a year. Above that, people can take out private insurance. Predictably, the public sector is getting stuck with most of the bad risks, whereas private insurers can cherry-pick younger and richer customers.

These arrangements are increasingly creating a wasteful two-class health-care system. Because private insurers pay higher fees, for instance, their clients usually get seen more quickly and receive better treatment. To keep revenues flowing, highly trained hospital doctors often attend to the minor illnesses of these private patients rather than doing research.

To Mr Lauterbach, the solution is to slash bureaucracy and introduce more competition. But even then it would take time for the health-care system to become more efficient, if experience in other sectors is any guide.

Power games

For a demonstration, take a trip to Bonn, Germany's former capital, half an hour's drive south of Cologne. In a sense, it has now become the capital of competition, housing the country's most important regulatory agencies: the Federal Cartel Office and the Federal Network Agency, a body overseeing competition in telecoms, railways and energy. The city is also home to the Max Planck Institute for Research on Collective Goods, a research body, and the Monopolies Commission, a group that advises the government.

In 2004, the Monopolies Commission published a scathing report about the state of Germany's

electricity industry. Martin Hellwig, then chairman of the commission (and now executive director of the Max Planck Institute), and his colleagues argued that the industry was a classic case of deregulation gone wrong.

When Germany decided to liberalise its electricity market in 1998, the electricity companies, which until then had been regional monopolies, had to open up their grids to other producers, so consumers and firms could pick their provider. However, constitutional problems made it impossible to separate power generation and distribution. Yielding to German corporatism and efficient lobbying, the government decided to let the industry regulate itself by negotiating the conditions for network access among the competitors.

In the early years, prices did indeed fall, though mainly because there was plenty of spare capacity. At the same time, the electricity industry consolidated, both horizontally and vertically. Now only four companies—E.ON, RWE, Vattenfall Europe and EnBW—control more than 80% of power generation and most of the grid. In recent years they have also bought stakes in local power companies, which makes these unlikely to switch to other providers.

As the Monopolies Commission argues in its report, this market structure, in combination with the regulatory environment, does not make for much competition. In particular, the fees for access to the grid are exceptionally high compared with other countries, discouraging firms from using alternative suppliers. No surprise, then, that electricity prices in Germany are among the highest in Europe.

Equally predictably, power companies argue that the connection is not clear and that their costs and taxes have gone up too. But the pressure on them is mounting. Last summer, the outgoing government passed a law putting the Federal Network Agency in charge of regulating the electricity market from next year. Until then, state governments are supposed to block unjustified rate hikes, which some of them have actually done recently. The tabloid papers have started campaigns against the “power rip-offs”, and public prosecutors are looking at junkets for local politicians paid for by the energy giants' gas subsidiaries, which are also accused of overcharging.

It may be tempting to see the protests against high energy prices as a sign that Germany, once a prime example of a producer-driven economy, is turning into one driven by consumers. But so far, the protests seem to be more of a populist uprising against big business rather than a call for more competition. Perhaps Germans have not quite grasped the virtues of freer markets yet. That certainly goes for immigration, the subject of the next article.

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Thinning blood

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Alamy

Almost like home

On immigration, Germany is torn between its past and its future

ASK Heribert Bruchhagen about the ethnic composition of his football team, and he has to consult his secretary. It is not that the boss of Eintracht Frankfurt, once one of the more successful German clubs, does not care. But when he recruits players, passports and origins are not much on his mind. More important is their price tag. And even more critical, all must speak German, and at least a third must hail from the Frankfurt area. “In times of crisis, the coach needs to be able to talk directly to the players,” Mr Bruchhagen explains in his office overlooking Frankfurt's stadium. “And the team must be rooted in the region.”

The resulting Eintracht squad includes quite a few names that suggest origins further afield: Du-Ri Cha, Jermaine Jones, Mounir Chaftar. Nearly half of them are foreign-born or have at least one non-German parent, but most of the second group grew up around Frankfurt. The recruitment policy seems to be working: after a bad start to the season, the club worked its way up to tenth place in Germany's premier league.

Every city, goes the joke, gets the football club it deserves. Thanks to its huge airport, its financial district and at one time the presence of many American companies' German headquarters, Frankfurt has become the country's most diverse city: some 40% of its population of 655,000 hold a foreign passport or come from an immigrant background. This has made Frankfurt unusually tolerant. “We have always welcomed immigrants”, explains Albrecht Magen, head of the city's integration department, “because we live and die by our internationalism.”

The politicians in Berlin, alas, are being less positive. After a brief period in 1999 when Germany

at last seemed to have accepted that it was an immigration country—and even began to see foreigners as an asset—things have again changed for the worse. “In Germany, immigration is still seen as hurting society,” says Klaus Bade, a professor at Osnabrück University.

Blood or soil?

Germany is not the only country that has problems with immigration, but it faces a special dilemma. In a way, it is torn between its past and its future: it still yearns for cultural homogeneity, but will in fact need more immigrants, particularly highly skilled ones, to make up for its low birth rate and to keep its economy competitive.

It is the “legacy of romanticism”, in the words of Dieter Oberndörfer, a political scientist at Freiburg University, that holds Germany back. Thinkers such as Friedrich Julius Stahl, a 19th-century lawyer, developed the idea that Germans are a people based on descent. “The older and purer the tribe,” he wrote, “the more it will be a nation.” This became mainstream thinking, at least among the ruling classes, and helps to explain why, some time after Germany had become a nation at last in the late 19th century, it decided to base citizenship on blood rather than soil.

The emphasis on ethnic origin also explains why Germany has seen a huge influx of foreigners with German roots since the second world war, mostly from eastern Europe. Individuals who could prove German ancestry were invariably welcomed. Immigrants without German roots were also admitted in large numbers, but on different terms: under Germany's “guest-worker model”, they were expected to go home when they were no longer needed.

Here to stay

Predictably, though, many of the 14m guest workers whom Germany allowed in between 1955 and 1973 stayed on, particularly the Turks. They also brought their families over, which resulted in many German-born foreigners. Add other immigrants, refugees and EU citizens (who can come and go as they please), and it is easy to see why the number of foreigners grew rapidly, from 500,000 after the second world war to 6.7m (8% of the population) today. Another 7m or so Germans are naturalised immigrants. In record time, all this has turned Germany into nearly as much of a nation of immigrants as America.

Yet it took German politics until the late 1990s to accept this reality. Both big parties often felt they had to pander to anti-immigrant, if not xenophobic views. There were fears that immigrants would take unfair advantage of Germany's still-generous welfare state. And integration often did not go smoothly. Many Turks, in particular, found it hard to settle in, not least because a large contingent came from rural Anatolia and had to get used to living in an industrial society as well as a Christian one.

It was only when the coalition of Social Democrats and Greens came to power in 1998 that things began to change. The first government of Gerhard Schröder passed a law making naturalisation much easier (although some *Länder* have now put up various new barriers). Yet faced with the threat of terrorism and a deteriorating economic situation, the federal government abandoned plans to liberalise immigration rules and instead concentrated on tightening security and improving integration. For example, a new immigration law passed in 2004 requires new immigrants to take German lessons.

Learning German is doubtless important, notes Ismail Ersan, chairman of the Türkisches Volkshaus, a cultural organisation for Turkish immigrants in Frankfurt. But those who push hardest

for it, he thinks, really want assimilation, not integration. Turning immigrants into Germans should not be the objective, he argues: “We need to find ways to live together, giving everybody equal opportunities.”

As yet, that is a distant dream. The third generation of Turkish immigrants, in particular, is increasingly marginalised—and not just because of the school system and the labour market. The exclusion starts when they become teenagers, explains Mr Ersan: they often switch to a Turkish football club at that point because their old German club makes it clear to them that they do not really belong there. When they have finished school, they are rarely offered even an unpaid internship, let alone an apprenticeship.

That is if they manage to finish school at all. According to a 2001 study by Bamberg University, 15.6% of young foreigners in Frankfurt failed to do so, compared with 6.5% of Germans. Far too many left school at 14. For Germany as a whole, the numbers are even worse. “The situation is certainly not as bad as in France,” says Mr Ersan, “but if things don't improve, cars may also be burning here one day.”

The Turkish community is also to blame. Many have retreated into ethnic ghettos: the availability of a complete Turkish infrastructure makes it possible for them to live in Germany without having much contact with Germans. The fact that Turkish men in Germany increasingly look for wives in Turkey does not help: their children are often raised the traditional way and do not learn enough German to integrate properly.

Immigration is not just about Turks, however, insists Helga Nagel, head of Frankfurt's office for multicultural affairs. Indeed, although they are certainly the most visible, they make up only about 20% of the city's foreign population (which more or less mirrors the national mix, see chart 6). Another 22% come from former Yugoslavia and 9% from Italy. And most, says Ms Nagel, are better integrated than you might expect.

If so, then her department deserves some of the credit. Frankfurt was the first German city to create such an office, back in 1989, after the Greens formed a coalition with the Social Democrats to run the city. When the Christian Democrats and Free Democrats took over in 1995, they did not abolish the office, as some had feared, and even kept its name.

Today, the office co-ordinates an impressive array of programmes. Apart from the obvious language classes and translation service, the staff also helps immigrants to find their way through the complicated German education system, get health care and sort out problems. The office also tries to monitor the state of integration—not an easy task because, perhaps unsurprisingly, Germany does not collect much information about its immigrants.

Other German cities have since copied Frankfurt's approach. But is that enough to integrate immigrants, particularly youths from a Turkish background? Unlike other countries, including France, Germany has never seriously discussed affirmative action for immigrants. Nor has it grasped that immigration policy today is no longer about keeping foreigners out or turning them into good Germans, but about competing actively in the global war for talent, says Thomas Straubhaar, president of the Hamburg Institute of International Economics, a think-tank. In a globalised knowledge economy,

he argues, the wealth of a country will increasingly depend on highly skilled individuals. Yet such people are mobile and can choose where they want to live.

Tempt me

If Richard Florida, an economist at George Mason University,Virginia, has his numbers right, Germany still has more work to do to become a top choice for what he calls “high potentials”. In his 2005 book, “The Flight of the Creative Class”, he produces an index measuring the competitiveness of nations in terms of the “3 Ts” of economic growth: technology, talent and tolerance. Germany does not come out too badly on tolerance, but it lags in developing talent and implementing technology. Overall, it ranks only tenth in the “global creativity index”.

Germany's 2004 immigration law will do nothing to improve that ranking. Foreigners who have graduated from German universities can still be sent packing even if they have found a job. And highly qualified workers still do not get permanent residence permits. As a result, the numbers of these “high potentials” moving to Germany is declining: in the 11 months to November 2005, only 900 arrived, compared with 2,300 in 2004.

Mr Bade of Osnabrück University thinks this is all the more serious because many highly qualified Germans are leaving. The numbers are hard to pin down, but between 1991 and 2003 an average of 115,500 people emigrated, many of them young and holding a university degree, according to the 2004 report of the Expert Council on Immigration and Integration, of which Mr Bade was deputy chairman (and which has since been disbanded).

A couple of hours' drive south from Frankfurt lies Stuttgart, Germany's second most international city, which has produced a raft of ideas for retaining and attracting highly skilled people. In 2001, the city launched an action plan to prepare itself for becoming even more international. To foster integration, Stuttgart offers much the same activities as Frankfurt. But in addition, it tries to make itself as attractive as possible to the global creative crowd. Foreign students, for instance, are offered help with things like finding their way through the thickets of German bureaucracy.

More recently, Stuttgart has started to combine its efforts to attract skilled individuals with policies to boost the low birth rate: it wants to become Germany's most family-friendly city. Over the next few years, it plans to introduce a range of measures to make life easier for parents and children, for instance by providing more day care, playgrounds and bicycle routes. This is not ideology or public relations but sheer pragmatism, says Wolfgang Schuster, Stuttgart's (Christian Democrat) mayor. To prosper, the city needs both more immigrants and more children.

What is good for Stuttgart, the home of DaimlerChrysler, might well be worth considering for Germany as a whole. Yet immigration does not seem to rank high on Germany's political agenda. The grand-coalition agreement mentions it only in passing, under the heading “security”. If that foreshadows neglect of the issue, it could turn out to be a serious mistake.

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Reincarnation valley

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The city of Jena provides a tantalising glimpse of the way Germany could be going

EPA

Alive and kicking

IF YOU seek Paradise, go to Jena. The bosses of this city in the eastern German state of Thuringia, two-and-a-half hours south of Berlin, may have been a little ambitious when they named the main railway station after an eponymous nearby park. Jena is clearly no Garden of Eden. Like any city, it has its problems, not least an unemployment rate of 12%. But it also offers a glimpse of Germany's future—and shows that Germany's east is not all bad.

Historically, Jena embodies the famous dictum by Louis Pasteur, the French chemist, that "chance favours the prepared mind." It was a fluke of nature that the city, by the river Saale and surrounded by heavily forested uplands, found itself near large deposits of quartz sand, chalk and soda. Thus endowed, people began making glass in the region in the 16th century.

Yet what turned Jena into a 19th-century Silicon Valley was its renowned university, which attracted not only famous thinkers such as Goethe, Hegel and Fichte, but also more business-oriented folk such as Ernst Abbe. Having developed new ways of making microscopes, he found himself what today would be called a contract manufacturer, Carl Zeiss, and a component supplier, Otto Schott. By the beginning of the 20th century, the firm Carl Zeiss had more than 1,000 employees.

It continued to grow rapidly, helped by the two world wars, but also suffering from them. Many of its plants were destroyed at the end of the second world war, and what remained was taken away, first by the Americans, then by the Russians. Still, Jena soon became the base of a huge *Kombinat*, as the big state-owned businesses were called in communist East Germany. This one had 27,000 employees when the Berlin Wall came down in 1989, about half of them in Jena, of whom more than 90% lost their jobs after the economic shock of unification.

Now Jena's city centre has been completely modernised, thanks to tons of money from western Germany. The former Zeiss factory has made way for the university and a big, smart shopping centre. What makes Jena different from many other eastern cities is that there is plenty of life on the streets. In some ways, the city seems a double of Berkeley, California, complete with well-wooded hills dotted with professors' villas.

Alexander von Witzleben, the boss of Jenoptik, the successor firm to Carl Zeiss Jena, has a splendid view of the city from his top-floor office on campus. "Frankly, if we were in the textile business, we would no longer be here," he says. The optics industry is hot again, he explains, particularly photonics—things like high-end lasers, optical sensors and specialised cameras, which Jenoptik is good at. To general surprise, the city was listed in a 2004 study as eastern Germany's

most promising business location.

Jena could easily have gone the way of other eastern industrial centres, where firms were bought by western competitors and then gutted or even closed down. Carl Zeiss owes its survival to Lothar Späth, the former premier of Baden-Württemberg, who became its chief executive in 1991. Counterintuitively, he bought a firm in the west, a builder of clean rooms and other industrial facilities, to give Jenoptik a western face and the cash flow to develop its photonics business. The firm, M+W Zander, was only recently sold off to allow Jenoptik to concentrate on its core business.

Moreover, explains Mr von Witzleben, as a former politician Mr Späth knew how to keep this species at bay. And he had the foresight to protect what is perhaps Jena's most important asset: its network of highly skilled people. Former Carl Zeiss employees were allowed to use the firm's facilities to create their own companies, spawning many start-ups. This has given Jena an entrepreneurial ecosystem that is rare elsewhere in Germany.

Creative destruction

There are start-ups all over the city and several research centres on a campus up the hill. There is also the Technology and Innovation Park Jena, with about 60 firms, which demonstrates that Jena no longer relies mainly on optics. Near the entrance is an incubator for biotechnology firms called Biocentiv. Stefan Russwurm, founder of SIRS-Lab, a diagnostics firm, says the experience of radical change when the Wall came down played a big part in his decision to start his company: “Otherwise I would not have had the flexibility. Back then, the world fell apart once a week.” Mr Russwurm chose Jena because he found conditions there particularly favourable. Almost a third of the city's working population have an academic degree, the highest share in Germany. They take pride in being Jenenser and don't go home early.

Jena also has a tradition of liberalism. It was here that the first *Burschenschaft*, or fraternity, was founded in 1815, starting the free-speech movement of its time. In the 1980s, the city was the centre of the eastern German peace movement, and became one of the first to mount Monday rallies, the regular demonstrations that helped to bring down the communist regime in 1989.

All of this goes a long way towards explaining the unusual political landscape in Jena today. The city council is controlled by a very grand coalition that includes all of Germany's bigger parties except for the extreme right. The (directly elected) mayor, Peter Röhlinger, is a Free Democrat who was a vet before winning his first vote in 1990. “Citizens here are quite demanding,” he says. “They want us to make the most of our opportunities.”

This has often meant doing things differently. For example, Jena did not shut down its nursery schools when money was tight, but persuaded their staff to work part-time. It also chose to build its shopping centre right in the middle of town rather than on the outskirts, which has kept the city centre alive.

Most importantly, Jena is trying new ways of dealing with long-term unemployment and education. Some of the results can be seen on the Tatzendpromenade, one of the city's main streets. On one side there is Jenarbeit, the agency run by the city to find jobs for those who are unemployed for more than a year. When labour-market reforms were brought in last year, the city decided against an *Arbeitsgemeinschaft* with the Federal Employment Agency, which it felt would not have taken enough account of local conditions. Instead, it set up an independent local organisation to look after its long-term unemployed, the only eastern city to do so.

The comprehensive school across the street, called Jenaplan, aims to ensure that its pupils will not become unemployed in the first place. Visit the school, and you may see a couple dressed in black

doing the tango as part of a project about the dance. Such projects are an important component of the school's life and often involve a mixture of age groups. “This allows for much more individualised learning,” says Gisela John, the principal.

The Jenaplan school exists because a group of teachers took the initiative to revive this particular form of learning, originally developed in the 1920s, and the city of Jena as well as the Land of Thuringia let them get on with it. Jena's education system is exceptionally diverse for a city of 100,000 people: it includes several all-day schools, a Montessori school, a bilingual high school and another one specialising in sport. Given so much variety, the usual distinctions between the *Gymnasium* and other forms of secondary education fade into the background.

In some ways Jena has had an easier time of it than other German cities: foreigners make up only around 5% of its population. This is not because it is especially xenophobic (though there have been cases of racially motivated violence that have prompted citizens' protests), but because the former eastern German government let in only small numbers of immigrants, mainly from Vietnam.

However, the numbers are bound to rise, if only to fill the gaps created by the low birth rate (which is even more pronounced in eastern than in western Germany) and the continuing migration of younger people to the west. “By 2009 at the latest, we won't have enough good candidates for all our apprenticeships,” worries Jenoptik's Mr von Witzleben. For Jena's economic dynamism to continue, he says, it may have to try to attract highly qualified foreigners.

Jena has other weaknesses too, not least that its two other large firms, Jenapharm and Schott, are being downgraded to mere manufacturing sites by their parent companies in west Germany; and that there is a marked absence of the Silicon Valley kind of venture capitalist. But the city is still the best preview available of what Germany might be capable of if the state let go.

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Letting go

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Germany needs to loosen up—or face decline

ANGELA MERKEL has a mission: putting Germany back among the “first three” of Europe's top nations within ten years. The German chancellor has yet to explain what exactly that would mean. But if things went well, a repeat of this survey in 2015 should be able to report that in the past decade the country had thoroughly modernised its education system; that unemployment had fallen to a bearable 3m; that recent years had seen a boom in basic service jobs; and that Germany had become a top destination for the world's creative crowd.

Alas, not everybody believes that this will come to pass. Wolfgang Streeck at the Max Planck Institute for the Study of Societies, one of Germany's foremost social thinkers, reckons that things are getting worse rather than better. Back in 2003, he wrote: “There is little hope that the German political system will overcome its present immobility, making continued social and economic decline the most likely scenario for the future.” Today he goes further: he argues that even a grand coalition will have to face the fact that the German state, “has, perhaps irreversibly, exhausted its means”.

To make a real difference, the government would have to do a whole host of things at once: cut payroll and corporate taxes, balance the budget, reduce debt, invest more in education and infrastructure and integrate immigrants. Yet given that the state's coffers are empty and growth is likely to remain moderate, that is an impossible task.

So what is an “exhausted state” to do? To find an answer, think about Germany's post-war history. Perhaps the main reason for the country's success has been its rebirth as a “semi-sovereign state”, a term coined by Peter Katzenstein, a political scientist at Cornell University. The state was weak and fragmented and had to rely on non-governmental bodies, such as trade unions and employers' associations, to get things done.

Yet over time, this system, which originally was quite flexible, has become ossified. Changes in one part of the system have became extremely difficult because they often have undesirable consequences in another. According to a well-worn German political adage, “everything is linked with everything.”

Germany needs to loosen up, and in some ways it is already doing so. For example, trade unions have quietly abandoned rigid industry-wide collective bargaining. But the state itself still needs to learn how to let go. Thorough reform of the federal system, one that includes an overhaul of the “financial constitution”, would give the *Länder* more freedom to do their own thing. But the *Länder*, too, must let go, not least by giving schools and universities much more autonomy.

If you can't beat it, join it

Liberalisation is already making inroads anyway, although sometimes to the detriment of society's

outsiders. Education? More and more private schools are being opened for those who can pay for them. The labour market? Illicit work is rampant, with estimates putting it at 15% of GDP. Immigration? According to some experts, Germany is now home to around 1m illegal immigrants.

All this suggests that Germany's future lies in greater diversity. It would help the country's outsiders to share in and contribute to its success—and not just the economically underprivileged ones, but also those who simply see and do things differently, perhaps because they have lived abroad for a while. They, too, are all too often shut out or not taken seriously.

With the World Cup approaching, football may offer a lesson for Germany. The nation's favourite sport is currently facing problems similar to those of the country as a whole: not only have other countries' teams got much better, but foreign players have crowded out native ones in the German premier league. In the ranking of the International Federation of Football Associations, the national team has dropped from second place in 1998 to 17th now.

It was only after the country's humbling in the European Cup in 2004 that the German Football Association, a clunky, over-confident organisation, accepted the need for action. It hired Jürgen Klinsmann, a former German soccer star, as national coach. Mr Klinsmann, who lives in California and is seen as a “West Coast German”, has refused to move to Germany and still runs his own company. He exudes optimism and is willing to fight to get his way.

German football, it seems, is more willing to embrace change than the country as a whole. “A monopoly that isn't capable of innovating from within will be swept away at some point,” says Theo Zwanziger, the Football Association's new vice-president. Germany would be well advised to heed his words.

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Feb 9th 2006
From The Economist print edition

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Corporate reputations

The blog in the corporate machine

Feb 9th 2006 | CHICAGO
From The Economist print edition

Bloggers can be vicious, but they can also help companies avert disaster

THEY have always had their critics, but corporations are having an especially hard time making friends of late. Scandals at Enron and WorldCom destroyed thousands of employees' livelihoods, raised hackles about bosses' pay and cast doubt on the reliability of companies' accounts; labour groups and environmental activists are finding new ways to co-ordinate their attacks on business; and big companies such as McDonald's and Wal-Mart have found themselves the targets of scathing films. But those are just the enemies that companies can see. Even more troubling for many managers is dealing with their critics online—because, in the ether, they have little idea who the attackers are.

The spread of “social media” across the internet—such as online discussion groups, e-mailing lists and blogs—has brought forth a new breed of brand assassin, who can materialise from nowhere and savage a firm's reputation. Often the assault is warranted; sometimes it is not. But accuracy is not necessarily the issue. One of the main reasons that executives find bloggers so very challenging is because, unlike other “stakeholders”, they rarely belong to well-organised groups. That makes them harder to identify, appease and control.

When a company is dealing directly with a labour union or an environmental outfit, its top brass often take the easy route, by co-opting the leaders or paying some sort of Danegeld. Until a couple of decades ago, that meant doling out generous union contracts and sticking shareholders, taxpayers or consumers with the bill. More recently, the fashion has been for “corporate social

responsibility”. This might involve spending money on a pressure group's pet project; or recruiting prominent activists to a joint committee, dedicated to doing good works.

In the blogosphere, however, a corporation's next big critic could be anyone. He might be an angry customer or a disgruntled employee—though that sort of tie to the company is not essential; nor does he need lots of industry experience or lengthy credentials to be a threat. All a blogger really needs to devastate a company is a bit of information and plausibility, a complaint that catches the imagination and a knack for making others care about his gripe.

Mike Kaltschnee's site, HackingNetflix.com, became a force to be reckoned with for Netflix, a video-rental outfit that delivers to people's homes. When Netflix said it was not interested in Mr Kaltschnee passing on questions from consumers, he posted the exchange online, hurting the firm's reputation among loyal customers. The company now treats him much more respectfully and his site has gained a large following.

Increasingly, companies are learning that the best defence against these attacks is to take blogs seriously and fix rapidly whatever problems they turn up.

One firm that could have saved itself a lot of trouble is Diebold, an Ohio-based firm that makes automated cash machines. After America's presidential election in 2000, which featured a vote-counting fiasco in Florida, the firm decided to expand a part of its business that made electronic voting machines by acquiring Global Election Systems (GES) in early 2002. The deal turned into a disaster when computer scientists and voting-rights groups educated the public about problems with machines such as those made by GES. The critics complained that GES's voting devices could not leave an audit trail because, among other flaws, they did not print paper ballots. By 2004 the mainstream print and broadcast media were also hammering away on this issue, leading several states, including Ohio, to reject GES's machines.

Evolve24, a consultancy which analyses corporate reputations and watches online trends closely, has used its blog-sniffing software to find out what was available on the internet before Diebold bought GES. It discovered that not only were a couple of voting-rights activists calling attention to the machines' drawbacks on their blogs well before the acquisition, but also that research papers highlighting the problems were available on technical websites. Diebold did traditional forms of due diligence before buying GES, such as verifying its financial health. But by ignoring the blogosphere, it failed to spot some crucial risks.

Although its response was much quicker than Diebold's, Kryptonite, a firm that makes high-priced bicycle locks, also learned the hard way how important blogs can be. In September 2004 word spread quickly through the blogosphere that U-shaped locks by Kryptonite and other firms could be picked, quickly and easily, using only the plastic casing of a Bic pen. Then somebody made a video showing how to do it, and posted it on the Engadget blog site, one of the most popular on the internet. After Kryptonite discovered the problem, it came up with a plan to take care of its customers and improve its locks. But Donna Tocci, Kryptonite's media chief, says that she now checks 30-40 blogs every day.

Not all company interactions with bloggers involve damaging criticism. Sometimes a careful look at what is happening online can help managers to avoid over-reacting. After the invasion of Iraq, when American consumers turned against all things French, a big French drinks company noticed that its brand names were popping up on boycott lists. But an analysis by BuzzMetrics, which specialises in scrutinising blogs and other online forums for corporate marketers, revealed that those who were pushing hard for a boycott tended to be “Budweiser drinkers”, who would not have been natural customers for the firm's wines and spirits anyway.

A hair of the blog

Many big companies have been looking eagerly for ways to tailor their advertising to specific groups of consumers. They have found that web logs and internet discussion groups, which bring together people of similar interests, can help them turn hot links into cold cash. But besides trying to get out their message, companies are also learning that blogs can provide early warning signs of potential problems.

They are increasingly turning to firms that can help them sort through the blogorrhea to find what they need. There is a lot to sift, considering that some 27m blogs are online. Last month, responding to growing interest in their services, BuzzMetrics agreed to merge with Intelliseek, another firm that specialises in analysing blogs for business. BuzzMetrics has ties to Nielsen, a media-research firm; Intelliseek has a clutch of former executives from Procter & Gamble, a consumer-goods giant.

Max Kalehoff, vice-president of marketing at BuzzMetrics, says that many of the firm's clients want it to analyse blogs so as to gauge the seriousness of bad news. Drugs firms, for example, want to know what questions are on patients' minds when they hear about problems with a medication. Car companies are looking for better ways to spot defects and work out what to do about them.

Steve Rubel, of CooperKatz, a public-relations firm, reckons that companies should also have a ready-made plan for influencing bloggers if a crisis does occur. Mr Rubel runs the firm's Micro Persuasion practice, which helps companies improve their marketing by using blogs and other conversational media. He recommends setting up a “lockbox blog” that is hidden behind an internet firewall, but can be made visible to the public at short notice. Any websites or video clips that companies might want to direct the public to in an emergency, for example, could be prepared in advance. Then, he likes to tell clients: “in case of emergency, break glass and blog.”

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Consumer boycotts

When markets melt away

Feb 9th 2006
From The Economist print edition

European firms feel the sting of a Muslim boycott

AFP

Carrefour puts prophet first

A YEAR ago, Arla Foods of Denmark was so confident of the potential to sell more dairy products in the Middle East that it switched production of processed cheeses from its home country to Saudi Arabia, where it had already been making dairy foods for 20 years. With regional sales of DKr2.9 billion ($465m), Arla already had the Middle East's best-selling butter. Its goal was to expand and double sales by 2010. “We've been here so many years now we believe the authorities consider us a local dairy,” an Arla official said at the time.

Apparently not. Decades of hard work by Arla have been wrecked in the past two weeks as it has been hit by a boycott of Danish products throughout the Muslim world. The company is losing $1.8m a day, and its products have disappeared from store shelves.

Across the region, nervous retailers fear a backlash from the row over cartoons depicting Muhammad. Carrefour, a French retailer, has drawn scorn in Europe for voluntarily pulling Danish products from its shelves in the Middle East—and boasting about it. Iran has raised the stakes by stopping all trade with Denmark, which accounts for about $280m in annual imports. The European trade commissioner warned Saudi Arabia that it could be hauled up before the World Trade Organisation, which it recently joined, if it is seen as supporting the boycott.

Danish goods worth about DKr10 billion a year are thought to be at risk in 20 Muslim countries. Other affected firms range from Novo Nordisk, a leading insulin-maker that reports a slump in use of its products by Saudi pharmacies and hospitals, to Lego, the big toymaker—although the Middle East accounts for less than 1% of its global sales.

While the Danes are in the crosshairs, others stand to gain. Seeking to squelch rumours that could dampen sales, Swiss-based Nestlé took out ads last week explaining that its products were not from Scandinavia. Fonterra Co-operative Group of New Zealand and Groupe Lactalis of France, both dairy companies, report new interest in their products. But since two French newspapers have now republished the cartoons, this may not last.

Companies can buy insurance to minimise losses from such maelstroms. But liability is not clear-cut and customers need to read the fine print carefully. “There are no *carte blanche*, financial-guarantee products,” says Charles Keville, a crisis-management expert at Aon, an insurance broker. Part of the difficulty, he says, is determining “when a so-called consumer boycott becomes

a political risk.” And now that Muslim wrath has spread beyond Denmark to other countries, Mr Keville says it is probably too late for European companies to buy coverage for political risk in the Middle East that takes effect immediately: “We'd look at any potential risk out there very nervously,” he says.

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General Motors

More pain, waiting for the gain

Feb 9th 2006 | DETROIT
From The Economist print edition

Drastic action as GM's cash pile runs down

LESS than three months after announcing plans to cut 30,000 jobs and close five of its assembly plants—moves described as “tough medicine” by Rick Wagoner, its chief executive—General Motors has gone back to the doctor for a fresh prescription. And this time, it seems, few connected with the carmaker will walk away without feeling some of the pain.

GM now plans to slice its dividend in half, while capping health-care coverage for some retired workers. Future pension benefits will be reduced sharply. Executive pay will be cut by at least 10%—Mr Wagoner himself will lose half his pay.

To an outside observer it looks as if Mr Wagoner and GM's management are finally bowing to pressure from Kirk Kerkorian, an 88-year-old Las Vegas-based corporate raider who is now GM's largest shareholder. Last month Jerry York, Mr Kerkorian's top lieutenant, laid out his own plan for turning around GM, in a speech at the company's Renaissance Centre headquarters. The treatment he outlined then sounded an awful lot like what GM is now proposing.

Nonsense, says Mr Wagoner, insisting that the latest moves have been in the works for months. Whatever the case, both sides now seem to agree broadly on what should be done—except for Mr York's demand to “euthanise” several of the carmaker's most damaged brands. Mr Wagoner remains convinced there is still a chance to save two of those brands, Buick and Pontiac. But then again, the executive admits “there will be additional actions” as GM looks for even more ways to trim costs. It has to move fast. Its loss amounted to $8.6 billion last year, and Mr Wagoner signalled that losses will continue for the foreseeable future, despite the latest cuts. In recent comments, Mr York has estimated that the company has just a thousand days' worth of cash left.

He will be in a much better position to check the figures in the coming weeks. Along with the latest cost-saving measures, GM's beleaguered board gave Mr York a seat at the table during a meeting on February 6th—satisfying one of Mr Kerkorian's long-standing demands. The company's initial hesitancy was understandable in some ways for those who remember the octogenarian investor's relationship with Chrysler a decade ago. Once one of the largest shareholders in Chrysler, which was then an independent company and the third-largest American carmaker, Mr Kerkorian mounted an ultimately unsuccessful takeover bid that eventually triggered Chrysler's decision to merge with Daimler-Benz.

Working through Mr York, the elusive Mr Kerkorian has tried to sound more like a team player while building his stake in GM. Mr York's demand to trim the dividend is not obviously self-interested, coming as it did from the company's largest shareholder. The United Auto Workers Union (UAW), which will see its membership shrink sharply as a result of the plans GM announced last November, applauded the smaller dividend. But after approving an additional $1 billion in health-care cuts, Ron Gettelfinger, the UAW boss, insisted: “We've done our share.” For the

moment, perhaps. But it is increasingly obvious that GM will seek bigger concessions when the two sides re-negotiate next year.

And while GM cuts dividends, jobs and benefits, Toyota keeps powering ahead. The Japanese firm is still gaining market share in America from both GM and Ford, and recently reported a quarterly profit of $3.34 billion. Alarmingly for GM, Toyota plans to boost its American sales by 5-10% this year. If GM's real ailment is competition from the likes of Toyota, the fear is that no amount of surgery and liposuction will provide a cure. “It is clear now, more than ever, that we have a shared fate,” Mr Wagoner said of the union, after GM announced its new deal with the UAW. The words have a slightly ominous ring to them.

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Reliance Industries

Oh brother!

Feb 9th 2006 | DELHI
From The Economist print edition

Another family feud is resolved, after a lot of crockery is thrown

INVESTORS in India's stockmarket had plenty to cheer about on February 7th. For the first time, the main market index closed above 10,000. The government revised its economic growth forecast for this financial year up above 8%. And peace was declared after another outbreak of fraternal strife in the Ambani family, which controls Reliance, India's largest private-sector group.

The group's founder, Dhirubhai Ambani, died in 2002. His two sons, Mukesh and younger brother Anil, have since squabbled bitterly about the succession. After months of unseemly wrangling, they agreed last June to divide the empire. Mukesh would retain Reliance Industries Limited (RIL), the group's flagship, encompassing its core petroleum and petrochemical businesses. Anil would inherit the telecoms, finance and power businesses. These would be hived off in four companies to be listed on the stockmarket separately, in each of which RIL shareholders received equity. So far these shares have been traded only in a “grey” market.

Early this month, signs of renewed trouble emerged when Anil's camp complained about the terms of a gas-supply agreement between RIL and one of the demerged entities. The accusation then broadened: Mukesh, it was claimed, was deliberately delaying the transfer of control of the companies to Anil, and using the window to sign agreements that had “substantial deviations” from the terms of the settlement. Mukesh's side riposted that Anil's side was dragging its feet over the listing of the four companies.

As can happen with family tiffs, it soon turned ugly. Anil's camp accused Mukesh's of a “deliberate and criminal attempt” to frustrate the transfer of shares, and of a “devious mindset and approach”. The other side said that the Anil group had “fraudulently” received more shares than it should have.

Just before the writs started flying, tempers cooled. Perhaps the brothers' mother, Kokilaben, who persuaded them to make up in June, had intervened again. For whatever reason, at a “cordial” meeting on February 7th, it was agreed that control of the demerged businesses would pass to Anil immediately, so that the listings could happen, as he hoped, under his regime.

A curious feature of the dispute is that, at every stage, each side claimed to be acting in the interests of RIL's 2.3m shareholders. It is not obvious, however, how these are furthered by accusations of outright criminality levelled at the most senior managers of both parts of the group.

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Air travel

Light up

Feb 9th 2006
From The Economist print edition

Why airlines have started charging for check-in bags

EVERYBODY has been there: stuck behind a group struggling at the check-in with a mountain of suitcases when all you have is hand-baggage for a flight that is soon to depart. Travellers without suitcases are now being offered more ways to speed past airport queues. And in their relentless quest to save money, two of Europe's biggest low-cost carriers will charge more for passengers with bags to check.

As fuel costs have escalated, airlines have been tightening up their baggage rules. Some of those rules are now being completely rewritten. British-based Flybe introduced a “fair deal for baggage” scheme on February 1st, which it says means passengers unburdened by bags will no longer have to pay towards carrying other people's suitcases. Five days later, Ireland's Ryanair announced details of a similar plan to encourage passengers to travel with fewer bags.

Both airlines say they will pass the savings on to passengers. Ryanair says its new web-based check-in facility means that from March 16th passengers with cabin-sized bags can avoid queues at check-in desks. But passengers who want to check bags will have to pay €3.50 ($4.20) per item. The company estimates this will lead to fewer bags, cutting airport and handling costs by up to €30m a year, a saving it will use to reduce average fares by €3.50.

Flybe's passengers will be charged £2 ($3.50) for each piece of check-in baggage booked in advance or £4 for each item that arrives unannounced. Passengers with just cabin-baggage will get a £1 discount. By knowing in advance how much baggage is expected for a flight, the airline says it will be better able to allocate resources and cut turn-around times. It is launching an online check-in service later in the spring. Both airlines will retain excess-baggage charges for those who have problems knowing how to pack.

Speeding up the check-in is likely to prove popular among passengers, especially those taking short trips. Flybe says only 55% of its passengers have bags to check, and it expects that number will now fall slightly. Because anything that persuades passengers to travel more lightly saves fuel and cuts the cost of ground services, other carriers will be studying this particular flight plan very carefully.

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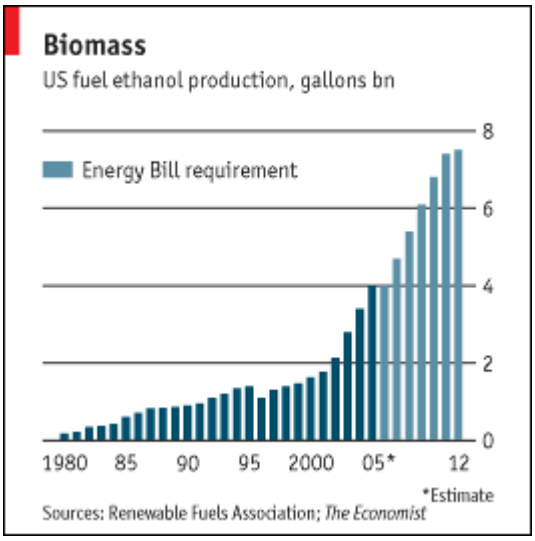
Ethanol

Life after subsidies

Feb 9th 2006
From The Economist print edition

A much-maligned alternative to oil comes of age

IT MUST rank as one of history's unlikelier conversions. President Bush is an oil man from Texas, and a reformed heavy drinker. But in his recent State-of-the-Union speech, the president declared that America is “addicted to oil”, and trumpeted the virtues of ethanol—an alcohol-based fuel. The virtue of ethanol is that it can power “flex-fuel” cars that can run on either petrol or alcohol. Mr Bush says he wants a vast expansion of the country's tiny ethanol industry. In particular, he wants “cellulosic ethanol”, prepared using an advanced technology, to become commercial within six years.



Will it happen? Ethanol will not replace oil anytime soon, but Mr Bush nevertheless has put his finger on something big. This once-sickly, over-subsidised industry is brimming with optimism.

America has traditionally made ethanol from corn. Alas, this is much less efficient than Brazil's sugar-cane ethanol or that using the cellulosic method. But the farm lobby's power means that America doles out billions in subsidies to corn ethanol—and imposes tariffs on imports of the greener, cheaper Brazilian variety.

High oil prices, government support and the promise of new technology have led to a veritable boom in production of American-style ethanol. Several billion dollars of investment led by agribusiness giants such as Cargill and Archer Daniels Midland are going into new production plants for corn ethanol. Daniel Kammen of the University of California at Berkeley argues that corn ethanol is not as bad as it seems: using it releases less greenhouse gas than burning petrol, he calculates, and its spread helps develop infrastructure for the much greener ethanol that should come onto the market in a few years' time.

But the biofuel to watch is cellulosic ethanol. It is made efficiently using powerful catalysts and enzymes to speed up natural processes. And it does not rely on valuable crops: it can use waste products such as straw, corn stalks or agricultural debris. Royal Dutch Shell has a joint venture with Canada's Iogen which plans to open a commercial plant by 2009. DuPont and Genencor, a biotechnology firm, are also busy developing better catalysts.

The best reason for optimism is the arrival of entrepreneurial capital. Paul Allen and Bill Gates, co-founders of Microsoft, have both made recent (but unrelated) investments in ethanol firms. Richard Branson, a British airline boss, has jumped into the fray with Virgin Fuels, a new firm that

vows to invest $300m-400m in ethanol over three years. Vinod Khosla, a venture capitalist at Kleiner Perkins, has also put his own money into start-up firms developing cellulosic ethanol and speaks with the zeal of a convert: “Bush is too cautious, it can take off much sooner than six years!” Perhaps. But will that mean an end to subsidies? Don't count on it.

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The delivery business

Pass the parcel

Feb 9th 2006
From The Economist print edition

Online shoppers give parcels firms a new lease of life

AFP

You got mail

THINGS must be going well in the parcels business. At $2.5m for a 30-second TV commercial during last weekend's Super Bowl, an ad from FedEx was the one many Americans found the most entertaining. It showed a caveman trying to use a pterodactyl for an express delivery, only to watch it be gobbled up on take-off by a tyrannosaur. What did the world do before FedEx, the ad inquired? It might have asked what on earth FedEx did before the arrival of online retailers, which would themselves be sunk without today's fast and efficient delivery firms.

Consumers and companies continue to flock in droves to the internet to buy and sell things. FedEx reported its busiest period ever last December, when it handled almost 9m packages in a single day. Online retailers also set new records in America. Excluding travel, some $82 billion was spent last year buying things over the internet, 24% more than in 2004, according to comScore Networks, which tracks consumer behaviour. Online sales of clothing, computer software, toys, and home and garden products were all up by more than 30%. And most of this stuff was either posted or delivered by parcel companies.

The boom is global, especially now that more companies are outsourcing production. It is becoming increasingly common for products to be delivered direct from factory to consumer. In one evening just before Christmas, a record 225,000 international express packages were handled by UPS at a giant new air-cargo hub, opened by the American logistics firm at Cologne airport in Germany. “The internet has had a profound effect on our business,” says David Abney, UPS's international president. UPS now handles more than 14m packages worldwide every day.

It is striking that postal firms—once seen as obsolete because of the emergence of the internet—

are now finding salvation from it. People are paying more bills online and sending more e-mails instead of letters, but most post offices are making up for that thanks to e-commerce. After four years of profits, the United States Postal Service has cleared its $11 billion of debt.

Firms such as Amazon and eBay have even helped make Britain's Royal Mail profitable. It needs to be: on January 1st, the Royal Mail lost its 350-year-old monopoly on carrying letters. It will face growing competition from rivals, such as Germany's Deutsche Post, which has expanded vigorously after partial privatisation and now owns DHL, another big international delivery company.

Both post offices and express-delivery firms have developed a range of services to help e-commerce and eBay's traders—who listed a colossal 1.9 billion items for sale last year. Among the most popular services are tracking numbers, which allow people to follow the progress of their deliveries on the internet.

How long will the boom continue? The parcel companies clearly see plenty of growth ahead—they are making big investments in new cargo hubs and aircraft. But in some areas the limits are already being tested. On February 2nd Amazon, the best-known online retailer, announced a 17% increase in sales to almost $3 billion in its busy fourth quarter. But profits fell because of higher shipping costs.

Amazon has been subsidising shipping to help boost its sales. Last year it introduced “Amazon Prime”, which provides free shipping in return for a one-off payment. The tactic is “very expensive”, Amazon's chief executive, Jeff Bezos, told analysts. But, he added, the early signs are that it does at least encourage people to buy more.

Yet internet-only e-tailers such as Amazon are also facing stiffer competition from bricks-and-mortar stores improving their own online offers, including supermarket giants such as Wal-Mart. Some of these also offer “pick-up in-store” options for people buying online but wanting to avoid shipping costs or having to stay at home to take deliveries. Some of the parcels firms have been experimenting with delivering goods to petrol stations, where people can collect packages on their way home. They are also trying to come up with more low-cost services. Convenient, cheaper deliveries will encourage more people to shop online.

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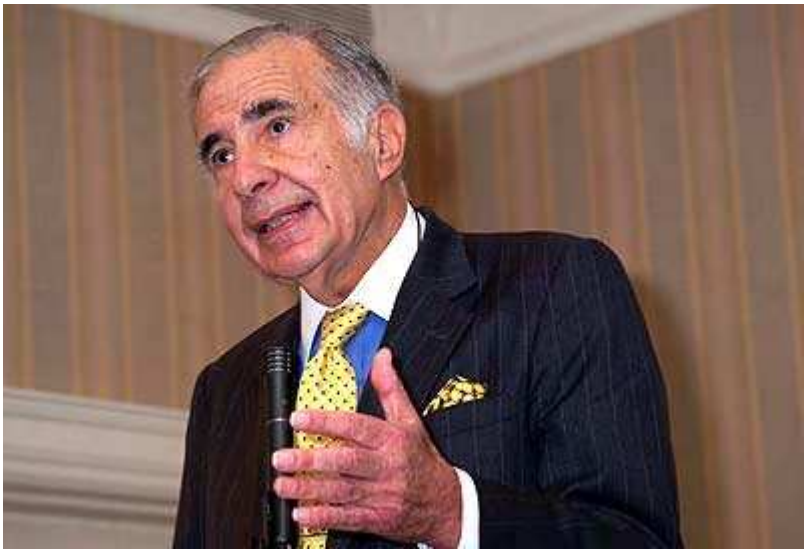
Face value

Time of his life

Feb 9th 2006
From The Economist print edition

Carl Icahn expects to have the last laugh in his battle to break up Time Warner

Landov



"I NEVER called Dick Parsons a moron," protests Carl Icahn. A few years ago, when the "corporate raider" was building his multi-billion-dollar fortune under intense scrutiny from a public largely hostile to his bids for firms such as Texaco and Nabisco, this remark would have been delivered defensively. Today it is designed to get a laugh, which it does. Mr Icahn may be making life a misery for Mr Parsons, the boss of Time Warner, but to anyone willing to share the joke he has now become capitalism's top comedian.

On this occasion, the 69-year-old New Yorker is entertaining a crowd of Wharton business school alumni with a talk on "The Future of Corporate Democracy", a boring title for a series of wisecracks and witty barbs that somehow combine to make a serious point. Just before putting the audience right on his views about Mr Parsons, Mr Icahn had expounded his theory of the moronisation of American management. The typical chief executive, he said, to chuckles, is "the guy you knew in college, the fraternity president—not too bright, back-slapping, but a survivor, politically astute, a nice guy". To be a chief executive, you need to know how not to tread on anyone's toes on the way up. You eventually become the number two, who "has got to be a little worse than the number one to survive". When the number two becomes chief executive, he promotes someone a little worse than him as his second-in-command. "It is the survival of the unfittest," concluded Mr Icahn. "Eventually we are all going to be run by morons."

Still, Mr Parsons is a "very nice guy" (more laughter). "I don't think Time Warner has reached the

point of moron. It may be getting there, but it isn't there yet," says Mr Icahn, who has been fighting since last summer to get Mr Parsons to raise his game and with it the media giant's share price—moribund since everyone realised that the 2000 merger between Time Warner and AOL was a ghastly mistake.

On February 7th Mr Icahn held a packed press conference to unveil a blueprint for Time Warner prepared by Lazard's veteran investment banker, Bruce Wasserstein. Under the plan, Time Warner would split into four separate companies, buy back some $20 billion of its own shares, and shed layers of overpaid bureaucrats in the firm's gleaming new twin-towered headquarters in New York's Columbus Circle.

"Columbus Circle" is Mr Icahn's shorthand for all that is wrong with Time Warner, and indeed corporate America. Again and again, he picks on the staff restaurant in Columbus Circle, with its butlers and magnificent views of Central Park: proof, he says, of why his plan to create $40 billion of shareholder value by breaking up Time Warner is a "no-brainer".

It is not just Mr Parsons who is sceptical. Over the years, Mr Icahn has rubbed plenty of people up the wrong way. Although highly intelligent (he graduated *summa cum laude* in philosophy at Princeton), he has been described as "tone-deaf, challenged—in the modern lexicon—in interpersonal dealings". Some of his peers call him "pure id", meaning that he focuses power and aggression more effectively than they do. Many of his early deals were financed by Michael Milken, the infamous junk-bond guru. Mr Icahn was reputedly one of the inspirations for Gordon "greed is good" Gekko in the 1980s film, "Wall Street". Mr Gekko's one-liner, "If you need a friend, get a dog", is a favourite Icahn joke.

Mr Icahn used to be known as a greenmailer, meaning that he would happily sell his stake in a firm he targeted to its managers for a higher price than was available to other shareholders. His critics claim that he has done far better out of his investments than many of the firms he invested in, and charge that his operational management has often been poor. TWA, an airline he acquired by hostile takeover in 1985 and loaded with debt, later went bust three times before being bought by American Airlines, for example.

To deflect this criticism, Mr Icahn has made it clear that he has no intention of managing Time Warner. He has chosen an experienced, if much-fired, media executive as his candidate to run the firm, and will shortly announce a slate of candidates for election to its board.

Imperial Icahn

Mr Icahn accuses Mr Parsons of running Time Warner with a focus that is too short-term. But Mr Icahn himself adds to the pressure on managers to be short-termist, says one of his fiercest critics, Martin Lipton, a prominent Wall Street lawyer. "We have gone from the imperial CEO to the imperial stockholder," he says. The increasing influence that the likes of Mr Icahn have over boards of directors "is increasing short-termism, reflected in a reluctance to do long-term investments," says Mr Lipton.

Mr Icahn rejects this accusation in typically robust fashion, arguing that shareholders remain very much the underdogs against established management. "It is as if the head of the death squads in Haiti when the peasants revolted said 'We have to protect the dictator from those imperial peasants'." The point is well made, even if Mr Icahn, a billionaire, makes an unlikely peasant.

Will he win? Mr Icahn controls just 3% of Time Warner, and, given the reluctance of most shareholders to vote against incumbent management, he faces an uphill struggle. Yet his campaign has touched a nerve. It is hard to find a shareholder who is happy with Mr Parsons.

Right now, says Bob Monks, a veteran corporate-governance activist, Mr Icahn, for all his faults, “is the manifestation of the legitimacy of ownership power and its entitlement to demand accountability from management”. If he wins, it will be a clear sign that shareholders are at last beginning to take seriously their responsibilities as owners. And one thing is certain: Mr Icahn will be laughing all the way to the bank.

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European energy markets

The politics of power

Feb 9th 2006 | BRUSSELS, MADRID AND PARIS
From The Economist print edition

Concerns about security have driven the liberalisation of Europe's energy market into reverse

WHEN Russia cut off gas supplies through Ukraine at the start of this year all of Europe took fright. The European Union's long-term energy supply plans, which depended in good part on Russian gas, suddenly seemed naive. Although the gas was quickly turned back on, prices have been rising sharply during what has been a cold winter in many parts of Europe. From Italy to Britain, fears about global warming have put energy policy, including the possible reintroduction of nuclear power, on the agenda.

Meanwhile, European energy companies have continued to consolidate, but, controversially, mostly within countries rather than across borders. In the latest such deal, Gas Natural and Endesa won approval for a €22 billion merger that would combine Spain's biggest gas and electricity companies to create a new national champion.

Behind all of this activity is an intense debate over the future of energy and its impact on Europe's economy. On the one hand is a longstanding project for lower prices led by the European Commission designed to liberalise the market and enable producers and distributors to compete freely within and across national borders. On the other is a camp that argues with growing confidence against further freeing the market. In its view, long-term security and stable prices can best be preserved in managed national markets that are dominated by strong quasi-monopolistic companies which can withstand bullying producers and sudden shifts in demand and supply. It may be no coincidence that many of continental Europe's biggest energy groups peddle this argument—after all, the less competition there is, the higher prices can remain.

This tension has big implications for businesses across Europe. Today business customers in different countries pay prices that vary by as much as 100% across what is supposed to be a single European market. And, playing on fears of insecurity, suppliers try their best to tie customers into long-term contracts—sometimes lasting ten or 15 years. That harms the development of transparent spot prices, further hindering the growth of competition. A freer market in energy promises to reduce prices back to something like a Europe-wide clearing level. Energy is a critical input to businesses, especially manufacturing, and rising prices are putting unwelcome pressure on already tight margins, as companies try to compete with emerging low-wage economies in Asia.

Is it a good idea to push for liberalised markets, or, as many critics claim, would that simply open the way for black-outs, uncontrolled price manipulation and gouging, as America experienced in California's notorious electricity crisis in 2000-01? Is energy provision too important at a strategic level to be left to the market? How much is this a politically and commercially convenient argument deployed by those who doubt the entire single-market project and are seeking to protect national interests?

Some answers lie in the one part of Europe's market that has been liberalised. In contrast with America, Britain is a role model for successful deregulation. After privatisation in 1990, the country's energy sector went through a period of intense restructuring. Today three of the six dominant companies are owned by foreigners: npower and Powergen belong to the Germans and EDF Energy is owned by the French. Scottish Power and Scottish and Southern Energy, and Centrica, a gas retailer, are British.

Competition has been good for consumers. British businesses have paid lower prices for gas and electricity over the past 14 years than most of their European rivals, says Ofgem, Britain's energy regulator. They continue to pay less, even though the past year saw steep price increases and fears over supply. Indeed the British market has so far withstood an unexpectedly rapid fall in North Sea gas supplies and a cold winter. It looks as though the market will remain tight for a while, but higher prices of wholesale gas and electricity, for which gas is a big fuel, have stimulated new investment in liquefied natural gas terminals and helped the prospects of a new generation of nuclear plants.

Continental drift

Britain is not a self-contained market, and companies such as Centrica complain bitterly that its consumers are now suffering because of stalling liberalisation of energy markets on the continent. According to a report commissioned by Centrica from Global Insight, a consultancy, continental Europe's failure to liberalise and its predominance of long-term supply contracts have maintained the link between the price of gas and the (rising) oil price. This means that the gas price is largely isolated from actual supply and demand and is open to manipulation by big suppliers. That could cost British gas users some £10 billion ($18 billion) in extra bills this year.

The stalling of liberalisation has defied a hefty legislative programme designed to ensure that Europe's market would be completely open by the commission's deadline of July 2007. Since 1999 big companies have been able to choose among rival power suppliers and in July 2004 all business users won that right, at least on paper. In December Leon Brittain, a former EU competition commissioner, predicted that by summer 2007 EU members will probably have gone through the formal process of implementing the three energy directives. Despite this, the reality is that the supposedly open market will remain a collection of national markets with relatively few of the interconnections needed for a competitive flow of energy.

The failure to liberalise has several causes. First is deliberate state interference motivated by a

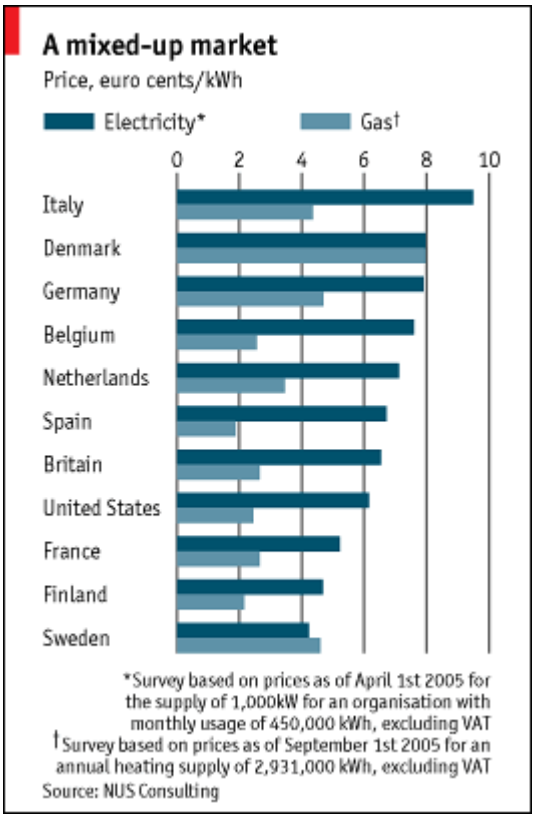
desire to build strong national competitors. Second, and directly related, it has not really been in the interests of the big companies to improve the infrastructure in ways that would allow more competition. Third, although enforcers at the commission have some teeth, they cannot counter a lack of effective local regulation. Each of these will have to be overcome if a genuine market in energy is to be possible.

Because energy is so important, it has long been seen as a proper area for government policy. France and Germany have done their best to comply only minimally with the requirements of EU legislation, all the while bolstering their electricity and gas giants—Electricité de France (EDF), Gaz de France (GDF) and E.ON and RWE in Germany. Although Britain and the Scandinavian countries have completely freed their energy industries, consumers in these countries cannot fully benefit from the gains of competition. About 80% of Europe's energy markets are rigid, while the rest suffer all of the price volatility, says William Ramsay, deputy head of the International Energy Agency.

Although entrenched monopolies have lost a little of their strength over the past few years, they remain dominant in France, Italy and Spain. German utilities have reinforced their position since the merger of E.ON and Ruhrgas in 2003; Gasunie dominates the wholesale market for gas in the Netherlands and France's Suez controls the gas and electricity market in Belgium through its local subsidiaries.

No European energy executive is so crass as to campaign openly for turning back the clock on liberalisation. Rather, company bosses say they want to position themselves for the opening of the market while enjoying the bulwark of their privileged position at home. “We want to be ready for competition in Europe,” says Rafael Villaseca, of Gas Natural. Pierre Gadonneix, of EDF, says that it is very much in his company's interest to create a single market in energy.

EDF is a powerful European protagonist. It is the second-biggest energy company in Britain, the second-largest electricity firm and the third-biggest gas company in Italy, as well as the overall number three in Germany. But the French market has barely opened to outside competition: EDF still controls 86% of it. Enel, Italy's dominant electricity company, was allowed in last year only after months of horse-trading over EDF's 2003 investment in Edison, an Italian group. In the near future Enel hopes to fortify its position by starting to supply gas to French households.



Italy has gone further than France in opening its market to outsiders. Under pressure from Brussels, the government forced Enel to make divestments that have reduced its share of generating capacity from 80% to 40%. Endesa and Belgium's Electrabel snapped up a big chunk of these assets. “We have an independent highway and policeman,” says Simone Mori, who looks after regulatory issues at Enel. The company's Terna subsidiary, which operates the national electricity-transmission grid, has become a separate entity.

Even so, prices remain the highest in Europe (see chart) and the Italian government, owner of 30% of Enel and Eni, still tends to reward its friends when deciding who will run them. Until last year the government cited reciprocity for its decision to limit EDF's voting

rights in Italenergia, the holding company of Edison, the country's second-biggest electricity company.

The battle in Spain between Gas Natural and Endesa has been another politicised takeover. But the likely outcome will serve only to entrench established interests. The merged company will be stronger in Spain. But, further raising the barriers to integration, it will be weaker in the rest of Europe because it will have to sell its French and Italian subsidiaries.

It's a gas

A similar row went on for months in Germany three years ago. The government ignored the arguments of both the Cartel Office and the Monopolies Commission by allowing E.ON, an electricity giant, to merge with Ruhrgas, Germany's biggest gas company. Its blatant goal was to oversee the creation of a national champion capable of standing up to EDF and GDF.

The big continental firms are stout defenders of their market position and behaviour. A former senior executive of EDF argues the electricity giant was in fact a virtuous monopoly in the past and that prices rise when markets are liberalised. In his view consumers continue to benefit from EDF's dominance of the French market through lower prices compared with, for instance, Italy (though not, of course, with deregulated Britain). As both producer and retailer of electricity, EDF can arbitrage within its own business.

With its foray into gas, EDF has also embraced the industry's big trend. E.ON and Ruhrgas in Germany, Electrabel and Distrigaz in Belgium, Enel and Camuzzi in Italy and Gas Natural and Endesa in Spain are all examples of marriages between gas and electricity companies. This integrated model and dual-fuel strategy is by far the best for the companies, says one energy banker. But it runs counter to efforts to promote competition for their customers.

As the big get bigger, Mr Gadonneix thinks that mid-size companies will struggle to survive. Armed with rich war chests, Europe's biggest energy companies are all looking at potential takeover targets, especially in Spain, Britain, the Netherlands, Central Europe and the Nordic countries. Nor do they show many signs of wanting to throw off the yoke of government ownership or close affiliation with politicians. The French government sold stakes of 15% in EDF and 22% in GDF last year only after dithering until the last minute about whether to go ahead. Both deals were a great hit with small investors, but big institutions were sceptical about owning shares in companies that are under state control. Their worries have proved well founded: the French government, badly shaken by recent riots in the suburbs, intervened to stop GDF increasing its tariffs at the beginning of the year, fearing that a price rise during cold weather would cause renewed unrest.

From there to here

The second factor hampering integration is practical: how to transport gas and electricity efficiently across Europe's dispersed markets. The engineering challenge is far more tractable than big companies' collective will to undertake it. Interconnections between national electricity grids do not have enough capacity to allow prices to equalise across the continent. The EU has prescribed that interconnections should be able to carry at least 10% of national consumption, but few states have that great a capacity.

Though new links for gas transportation are being built, existing ones are not used to full capacity, says Britain's Centrica. For example, the interconnector pipeline between Zeebrugge, a gas-

transportation hub in Belgium, and Britain sometimes runs well below capacity, partly because excess gas is put into storage in the Netherlands and Germany instead of being released on to the market. That is mystifying when this gas could be sold abroad at a handsome profit.

Some say that the uncertainties of a deregulated market will create smaller companies less inclined to make long-term investments such as international links which take 10-15 years to build. Rubbish, says Rafael Miranda, boss of Endesa, who is also head of Eurelectric, a pan-European industry lobby. His company, owner of about 30% of the interconnections between France and Italy, is keen on enhancing the network, but local bureaucracies get in the way.

To many observers it looks as if big energy companies, far from seeing deregulation as the problem, have made so little effort to improve interconnections because energy trading is not in their interests. The weaker the cross-border network, the less price competition they face. Further, it suits them—as a justification for higher prices and national champions—that consumers have the impression that supplies are vulnerable. Whether they are acting as old-fashioned, risk-averse energy companies that have over-engineered their own networks and can store more gas than is strictly necessary (just in case, you understand) or whether they are keeping supplies lower than they would otherwise be, the effect is the same: entrenched companies with protected market positions.

The third problem in European energy markets compounds the first two. Europe remains a patchwork of national energy policies and regulation. The power of authorities in Brussels to intervene is limited. Although the commission can fine individual companies, it depends on national governments to push through liberalisation. According to Enel, of the big European countries only Britain and Italy have strong and independent regulators. Germany did not even have a regulator until the establishment of the *Bundesnetzagentur* last year. Spain's regulator is prone to yield to political pressure.

According to Mr Miranda, the lack of harmonised regulation and local regulators' distrust of the wider market are big obstacles to liberalisation. In addition, he says, energy directives are unwieldy and governments have been unwilling to work together. Loyola de Palacio, a former energy commissioner, campaigned without much success for common stocks of energy, or at least a system to co-ordinate national stocks. Her plan to establish an EU regulator was also shot down.

Nevertheless, the commission is reluctant to give up the fight. Andris Piebalgs, the commissioner for energy, and Neelie Kroes, the competition commissioner, are making an extra effort in the run-up to the final deadline for full liberalisation. But it is hard work.

In July 2005 the commission took Spain, Luxembourg, Greece, Estonia and Ireland to the European Court of Justice for their failure to implement the 2003 directives. Most member states missed the July 2004 deadline for implementing the second liberalisation package, catching up only in the following months.

If the second set of directives does not bear fruit, Mr Piebalgs says there will be a third effort. Last November he presented his department's yearly report on the functioning of the internal market. As well as pointing out stubborn price differentials, it noted that cross-border flows of electricity were 10.7% of total consumption in 2004, an increase of less than three percentage points since 2000.

A waste of energy?

Ms Kroes says that she is determined to use her powers as watchdog of mergers, antitrust and state aid to get the market to work. The commission can fine firms up to 10% of total sales for

anti-competitive behaviour. But so far, despite evidence of infringements, the commission has yet to fine an energy company.

Not that the commission has failed entirely to rein in anti-competitive practices. It successfully rapped Norwegian gas producers on the knuckles for collusion. It also obtained the dissolution of a Danish gas consortium. The commission will carry on fighting contracts that contain any clauses barring importers from selling on gas to other countries: until it intervened, for example, E.ON was not able to sell on gas supplied to it by Russia's Gazprom.

The EU liberalisation campaign is starting to energise national regulators. Germany's Cartel Office is arguing with E.ON about its long-term contracts, on the ground that they are unfair to newcomers seeking access to the market. In the past, E.ON struck contracts for 15 years or even longer with regional distributors, in effect locking competitors out of the market. The row continues, though for now E.ON has had to limit to two years any new contracts with companies getting more than 80% of their supply from E.ON and to strike four-year contracts when it provides half of a regional distributor's supply.

Endesa's Mr Miranda says Europe needs some €1 trillion of energy investment over the next 25 years to be able to meet increased demand. And that neatly encapsulates the stakes in the debate between the merits of a functioning free market and the solidity, but higher prices, of an essentially fixed one. At the moment, the current in Europe is flowing in the solid, but expensive, direction.

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China's securities industry

Fixing broken brokers

Feb 9th 2006 | HONG KONG
From The Economist print edition

A hidebound regulator is holding back reform of China's securities industry

CHINA has recently done much to repair its tattered commercial banks. By contrast, another important group of financial firms—its stockbrokers and investment banks—remains a sorry mess. Hit by a falling stockmarket, a dearth of flotations and bad management, the mainland's 130-odd securities companies lost 15 billion yuan (almost $2 billion) in 2004 and probably more in 2005. For years they have failed to make enough money to match the returns they guarantee their customers. Some have not paid up; some have eaten into their capital. All but ten or so are technically insolvent.

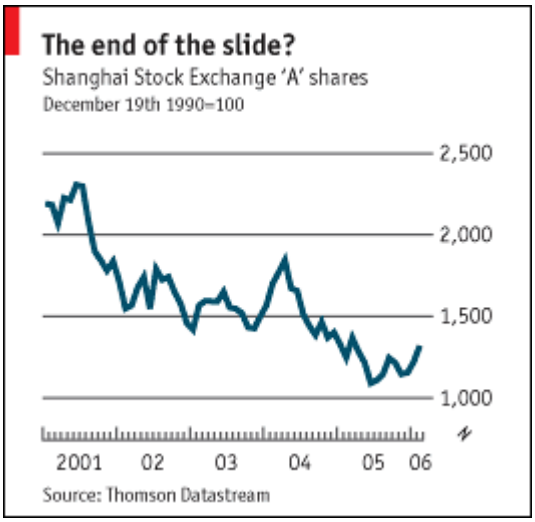
Their pitiful state is the prime reason why China's capital markets remain underdeveloped. Arguably, strong markets are as important as sound banks to the creation of a healthy financial system. Some $1.7 trillion of private savings languishes in domestic deposit accounts while thousands of growing companies are starved of funds. Equity and bond markets that could marry the two successfully would be a boon for the fast-growing economy.

Indeed, the securities firms should be easier to rescue than the banks. They employ only a fraction of the staff; putting them right requires far less money; and if some failed it would pose no systemic risk. Why, then, has progress been so much slower than in banking?

Part of the explanation is precisely that policymakers have been preoccupied with reforming the big lenders. In addition, a four-year decline in share prices has undermined securities firms' finances, making reform more daunting for officials who do not want to send brokers under. Here at least, pressure may at last be easing: cheered by bold measures to remove a vast overhang of

non-tradable state-owned shares, China's stockmarket has hit an 11-month high (see chart). Renewed interest in shares is prompting the authorities to improve the dreadful quality of quoted firms by lobbying better-regarded companies—such as Bank of China, which is due to float this year—to list at home as well as abroad.

However, the main cause of the securities industry's continuing problems lies with its regulator, the China Securities Regulatory Commission (CSRC). To its credit, the CSRC is dealing with the share overhang. But unlike its cousin overseeing the country's banks, it has done little to address the weaknesses of the firms in its charge. Although it has withdrawn licences from a few brokers, no big names have been allowed to go bust since China Southern Securities two years ago. Nor has there been much consolidation, although forced mergers of state firms are common in other industries. Under Shang Fulin, its conservative boss, the CSRC appears wary of offending the regional governments that are the ultimate owners of most securities firms. Instead, it seems to be hoping that a rising stockmarket will rescue the industry with no need for true reform.



Mr Shang's attitude to foreign involvement is especially unhelpful. At a private meeting last month the CSRC said it was putting all approvals of foreign deals on hold until the end of the year, according to a foreign banker present, reinforcing rumours of a ban on all deals after one between UBS and Beijing Securities.

The Chinese are under no international obligation to let foreigners into their securities industry. (Banking is different: China promised to open its market by next year as a condition of its joining the World Trade Organisation.) However, overseas brokers are pitching for minority stakes in joint-ventures with local firms. Their activities would be limited to primary services (ie, advising and underwriting) and bond trading, not the more lucrative businesses of secondary share trading and managing funds for Chinese investors.

Foreign firms are eager to help in return for access to a potentially profitable market. The world's investment banks are already doing well from Chinese companies' overseas flotations. The scope for underwriting, trading and advising on domestic and foreign mergers is growing: analysts at Merrill Lynch think investment banking, trading and advisory fees from mainland China will reach $12 billion by 2010. “In ten years' time, it is unthinkable that China will not be one of the world's largest capital markets,” says Rory Tapner, head of UBS's Asia-Pacific operations.

The sad story so far

Foreign houses can contribute the know-how, new products and technology that Chinese firms need but lack. Yet the few deals so far have yielded little. The earliest, a joint-venture called CICC set up a decade ago by Morgan Stanley and China Construction Bank, brought the Americans juicy mandates to float Chinese companies abroad, but not the entry to domestic markets they had hoped for. Worse, after squabbles with its Chinese partners—notably Fang Fenglei, a maverick banker who defected to Goldman Sachs—Morgan Stanley has stepped back. It still has a minority stake in CICC but has no one on the ground and no control. Insiders say it wants to tie up with another Chinese broker, possibly Shanxi Securities.

Other such ventures look uncertain. Merrill Lynch has been waiting since early 2005 for approval

to take a one-third stake in Hua'an Securities, based in Anhui province. J.P. Morgan is said to be pursuing Liaoning Securities—which recently lost its licence, prompting one banker to muse that "J.P. Morgan has the right idea, but is backing the wrong horse." Credit Suisse's talks with Xiangcai Securities, China's seventh-largest broker, have failed—at least for now—over control, structure and price, says Paul Calello, head of Credit Suisse Asia Pacific. HSBC and Citigroup are said to be sniffing around Xiangcai too.

Oddly, the two most promising and experimental deals, involving Goldman Sachs and UBS, most expose the regulator's shortcomings. In late 2004 Goldman helped launch a new securities company, Beijing Gao Hua. Goldman has no formal stake in Gao Hua, 75% of which is owned by Mr Fang, Morgan Stanley's former friend. Gao Hua in turn holds the securities licence and two-thirds of the operating joint-venture, GSGH. Insiders say Goldman has negotiated future ownership rights for Gao Hua through complicated private agreements with Mr Fang. If it all works, Goldman will have smartly side-stepped the need to join forces with an existing, indebted firm, and will gain full access to the domestic investment-banking business. However, much remains in the hands of Mr Fang.

More worrying for the prospects of reform, the CSRC has made the new venture a trial balloon for a proposal to remove brokers from clearing and settling share trades, and to hand these post-trade processes to the big state banks. The idea seems to have been prompted by the regulator's belief that domestic brokers are a corrupt bunch who misappropriate their clients' money. Rather than simply shut rotten brokers down, the trial merely adds complexity by forcing clients to make agreements with banks as well as brokers. Insiders at Gao Hua also dislike the regulator's idea that mutual funds should execute trades themselves, bypassing brokers. If brokers cannot match buyers and sellers, they say, liquidity will suffer.

Will UBS get more leeway? In the next few weeks it is expected to agree to buy, for $210m, one-fifth of Beijing Securities, one of China's biggest brokers. With the help of friendly co-investors, including the Beijing city government, it could secure control of the broker's management and even the board. Most of the money will go towards repaying its target's debt, allowing UBS to shed half the staff and 21 of the 27 branches. That should leave the Swiss bank with a smaller but healthier business and, says Philip Partnow, who is leading the deal for UBS, "a comprehensive licence to do everything", including trading shares and managing assets and wealth.

The state council, or cabinet, and the central bank, whose governor, Zhou Xiaochuan, used to run the CSRC, have browbeaten the securities regulator into approving UBS's deal. The CSRC is said still to be wrangling over how much control truly to cede to the Swiss. Its moratorium on further deals is a defensive step by an agency that should instead be opening its industry to foreign money, know-how and control. Unpalatable to the CSRC this may be, but it would help create the healthy capital markets China needs.

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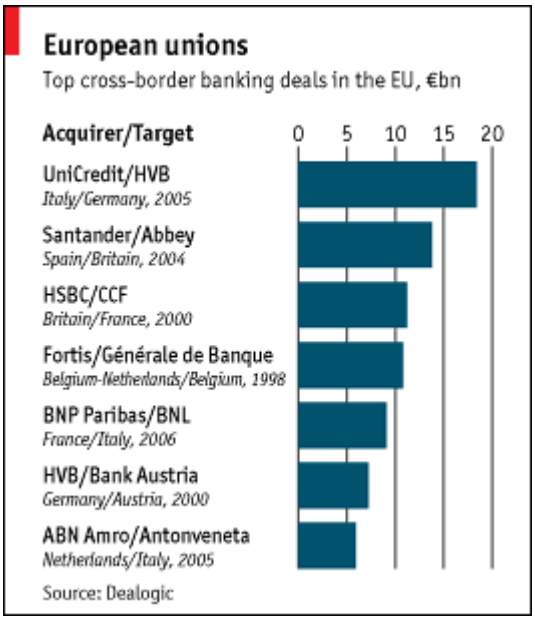
European banks

French raid

Feb 9th 2006 | PARIS
From The Economist print edition

BNP Paribas's swoop for Italy's BNL is unlikely to start a rush



THE move was quick, bold and unexpected. On February 3rd BNP Paribas, France's second-biggest bank by assets, declared that it was buying a 48% stake in Banca Nazionale del Lavoro (BNL) and would bid for the rest. The offer values BNL, Italy's sixth-biggest bank, at about €9 billion ($10.8 billion). If approved by regulators, this will be the biggest foreign acquisition ever by a French bank and the fifth-largest cross-border takeover in European banking (see chart).

BNL has been seen as a takeover target for three years, but BNP Paribas was never thought to be a potential buyer. Last year Spain's Banco Bilbao Vizcaya Argentaria (BBVA), which owns 15% of BNL, tried to buy the lot but hardly received enthusiastic encouragement from the Italian authorities. Unipol, an Italian insurer, then tried to play the national white knight. Its bid was eventually rejected by the central bank last week. When Unipol and 12 other shareholders were ready to sell, the opportunity was too good to let pass, says Baudouin Prot, chief executive of BNP.

Mr Prot's strike shows the attraction of Italy's banking market. It looks ripe for consolidation: the top five banks have a share of only 35%, against 72% in France and 80% in Britain. It ought to be profitable: Italians save more than the European Union average and pay higher bank fees. BNP's Italian operations, in consumer finance, insurance and corporate finance, already produce revenue of €750m a year.

Better still, following last year's battles over both BNL and Banca Antonveneta, the ninth-biggest bank, the country is now more open to foreign buyers. The rumpus over Antonveneta, which is now being bought by the Netherlands' ABN Amro, led to the resignation in December of Antonio Fazio, governor of the Bank of Italy, and his replacement by Mario Draghi, formerly of Goldman Sachs. Under Mr Fazio it was all but impossible even for foreigners with a big stake in Italian banks to buy control; those without did not even try.

The French bank's swoop is the biggest and latest of many purchases since it was forged from Banque Nationale de Paris and Paribas in 2000. BNP Paribas has since spent €13 billion on takeovers, mainly on smallish retail-banking deals. Last year it bought 14 companies, including Commercial Federal, an American retail bank, for $1.4 billion. “If the opportunity to buy BNL had not come up we would have continued our baby-step strategy,” says Mr Prot.

Despite BNP's bold move, a series of big cross-border deals looks improbable. No doubt BNP Paribas's domestic rivals, Crédit Agricole and Société Générale, would like a coup of their own. So might the thwarted BBVA, which is selling its stake in BNL to BNP Paribas. The trouble is that few big banks are worth buying. Analysts at Merrill Lynch say the number of possible prey has dwindled further now that ABN Amro, Germany's Commerzbank and Austria's Erste Bank have become buyers.

Surely, though, Italy is now open for business? After all, several foreign banks already own slices of Italian institutions. Spain's Grupo Santander holds 8% of Sanpaolo IMI, the third-biggest bank. ABN Amro has 9% of Capitalia, the number four. Crédit Agricole owns 18% of Banca Intesa, the largest. Italian banks are not huge: even Intesa, with a market capitalisation of €28 billion, would be no match for the top dogs of France, Germany and Spain. However, a bid for one of Italy's biggest and best would test its new openness: BNL is no giant and no jewel. Moreover, the top banks are subject to fairly tight shareholder pacts, which leaves only small regional banks as easy meat.

If deals across borders happen, they are likely to be takeovers of small banks by bigger institutions. Mergers of near-equals have rarely progressed beyond initial flirtations and have not always been happy experiences. The products of one or two have even been spoken of as takeover targets themselves. But none are so alluring as to be leapt upon *à la française*.

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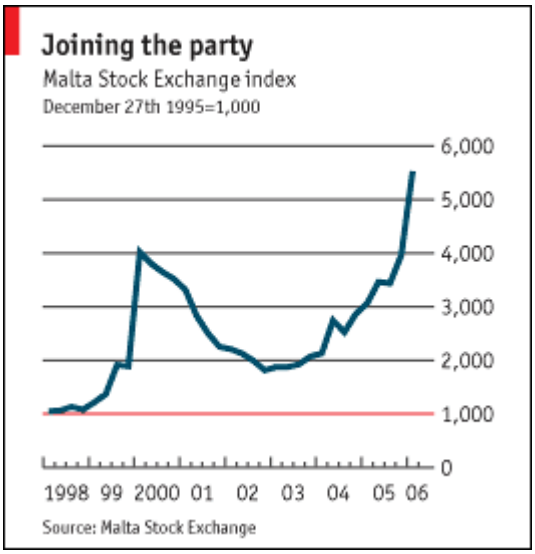
Malta's stock exchange

No exchange is an island

Feb 9th 2006 | VALLETTA
From The Economist print edition

Remarkable returns for a tiny bourse on Europe's southern fringe



A FORMER military chapel overlooking Valletta's harbour may seem an unlikely home for a stock exchange. But this is Malta, a tiny Mediterranean island where military might and religion have long been defining influences: the Romans, Turks, Spanish, Crusaders, French and British, not to mention pirates, have all left their mark.

Now Malta has grand hopes for its financial-services industry, which is drawing increased attention from abroad. Local officials say that, as a new member of the European Union, Malta would like to repeat the success of Dublin or even Luxembourg. The record of the Malta Stock Exchange (MSE) has helped. Its equity index surged by more than 60% last year, after a 40% rise in 2004 (see chart). But for a 7% limit on the daily movement of individual share prices, it might have risen faster still: a number of stocks were trading near the top of the range “regularly” last year, says Mark Guillaumier, the MSE's chief executive, a descendant of a French sea captain who landed in the 18th century to trade with the Knights of St John.

But Malta is a tiny place. The MSE lists only 13 stocks. Mr Guillaumier says there is too much money chasing too few investments in Malta, which has a population of just 392,000. Many locals have parked their money abroad. One of his goals is to drum up more listings by local companies, not easy given the number of family-owned firms.

In an era of consolidation, the independence of the MSE (owned by the government) is far from guaranteed. A partial sale or a link with another exchange is an option. OMX, the Nordic exchange operator that provides the all-electronic MSE's technology, is one potential partner.

Joe Bannister, head of the Malta Financial Services Authority, the regulator, contends that if the exchange is going to grow, “it has to grow through international business.” The MSE was recently named a recognised stock exchange by Britain's tax authorities. This has sparked interest in listing from foreign and local companies, because of the tax relief that such status offers investors. Other financial services are also looking up. There are 53 hedge funds, up from zero five years ago (although most are administered in Dublin). And retail funds and captive insurers are on the rise. Mr Bannister, who worked for years in Britain, says the EU will be key to Malta's success. “If we didn't go into Europe, I wouldn't be here.”

American International Group

Settling claims

Feb 9th 2006 | NEW YORK
From The Economist print edition

The world's largest insurer tries to write off its past

AT LEAST, AIG's bosses can console themselves, the official cost is known. On February 9th American International Group settled with federal and state regulators who had accused it of fiddling its accounts, bid rigging and other offences. The giant insurer will pay $1.6 billion, more than the whole of Wall Street coughed up to settle suits related to the underwriting of dotcom stocks and equity research three years ago.

Alas for AIG, more embarrassment lies ahead. On February 16th one of its former executives and three ex-employees of General Re, a big reinsurer, are due to be arraigned in Virginia on criminal charges over the use of two transactions that allegedly distorted AIG's earnings in 2000 and 2001. Although AIG will not be in the dock, the trial is scarcely welcome.

The indictment refers to co-conspirators who appeared to have been involved in the transactions but have not, or not yet, been charged. These deals resemble the ones listed last May in a civil suit filed by Eliot Spitzer, New York's attorney-general. Because Mr Spitzer named AIG's former chief executive, Hank Greenberg, the spotlight may yet shine even more brightly on AIG. Mr Greenberg opposes the settlement and has vowed to fight all charges.

Paying off the regulators will cost AIG slightly less than one quarter's earnings. The true cost of the accounting suit, however, is much higher. Before it, AIG's remarkably consistent returns earned praise from devoted Wall Street analysts. Its shares often traded at four times book value in an industry where less than two was typical. AIG's debt was pricey too, because for years the company was the only big insurer to enjoy an AAA credit rating.

The “Greenberg multiple” has now disappeared. AIG's shares trade in line with the industry; the AAA rating is gone. And Mr Greenberg has kept control of an affiliate that holds $20 billion in AIG shares previously earmarked for compensating employees, making his departure by far the costliest in corporate history.

AIG still has a unique international spread. But the extent of cross-border synergies is not plain. And its reputation has been bashed, in a business where reputation sells. On the plus side, AIG is considered one of America's most meritocratic companies. In the past, its employees' talents were often obscured by Mr Greenberg's. It can't afford that these days.

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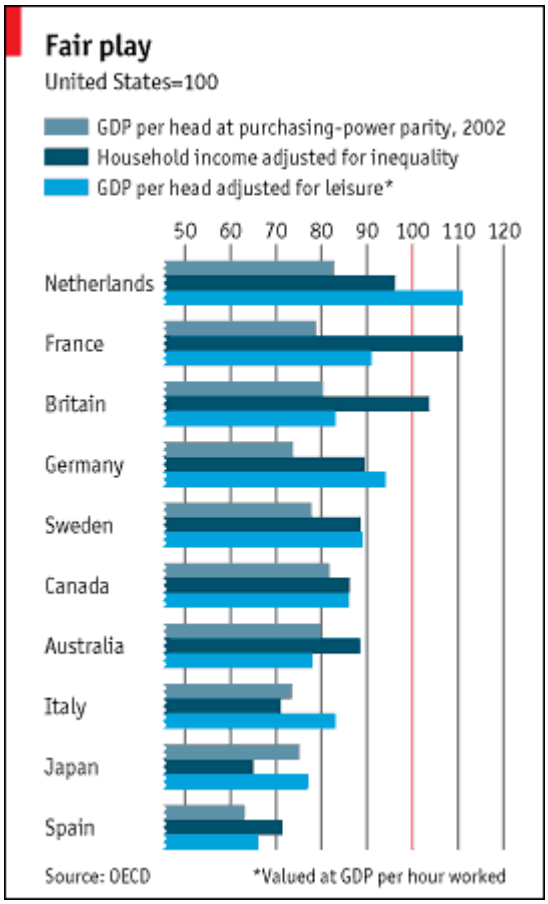
Measuring economies

Grossly distorted picture

Feb 9th 2006
From The Economist print edition

It's high time that economists looked at more than just GDP



THERE has been much hullabaloo about corporate accounting scams in America, yet perhaps the biggest accounting oversight of all time remains hidden in governments' own national figures. GDP per head is the most commonly used measure of a country's success, yet it is badly flawed as a guide to a nation's economic well-being. A new study in the OECD'S 2006 *Going for Growth* report considers some alternatives.

Economists spend much time discussing how to boost GDP growth. The OECD itself drew attention this week to the widening gap between America's and Europe's GDP per head. Yet a nation's well-being depends on many factors ignored by GDP, such as leisure time, income inequality and the quality of the environment. GDP was developed primarily as a planning tool to guide the huge production effort of the second world war. It was never intended to be the definitive yardstick of economic welfare. Would another indicator change the ranking of countries or their relative performance over time?

GDP is not even the best gauge of the monetary aspects of living standards. It measures the value of goods and services produced by the residents of a country. But some of the income earned in Britain, say, is paid to non-residents, while residents receive income from abroad. Adding net income from abroad to GDP gives us gross national income (GNI, also known as gross national product), which is more relevant for the prosperity of a nation.

Most countries' rank by GNI per head is similar to that by GDP. One exception is Ireland: its GDP per head is one of the highest in the OECD, but because of large net outflows of investment income, its GNI per head is merely around the OECD average. Its average GNI growth rate over the past decade has also been about one percentage point less than on a GDP basis.

Another flaw is that GDP makes no allowance for the depreciation of the capital stock. Subtracting this from GNI leaves net national income (NNI), which is probably the best national-account measure of welfare. Awkwardly, the numbers are harder to come by, making it difficult to compare across countries and over time.

But even NNI is an imperfect measure of people's welfare: it excludes the value of such important things as leisure, inequality and the environment. GDP should ideally be reduced to take account of pollution and the using-up of non-renewable resources, but no standard accounts that can do this are yet available.

On the other hand, the OECD has made a brave attempt to adjust GDP for the distribution of income. To most observers, a country where a few families enjoy huge wealth but most live in abject poverty would have a lower level of well-being than one with the same GDP but less poverty. A dollar of income is, in effect, worth more in the hands of the poor—though just how much more depends on attitudes towards inequality. The OECD's calculations suggest if people strongly dislike inequality, the gap between America and most other rich countries, which have a more equal distribution of income, should be greatly reduced (see chart). By this measure, adjusted income per head is higher in France than in America.

Imagestate

Boosting well-being, on a gross basis

Inequality has also risen in recent years in most countries. Assuming again a strong aversion to inequality, average adjusted income per head grew by only 0.6% a year in OECD countries between 1985 and 2002, against 1.4% for GDP per head. But such estimates are sensitive to big value judgments. If, instead, people care little about inequality, then the adjustment will be much smaller.

Longer holidays and shorter working hours increase an individual's well-being, yet conventional national accounts completely overlook such benefits. America is one of the world's richest countries, yet its workers toil longer hours than those elsewhere. As a result, adjusting GDP for leisure also narrows the gap between America and Europe. The OECD uses three different methods to place a value on leisure. Using the highest valuation (based on average GDP per hour worked), Germany's leisure-adjusted GDP per head is only 6% lower than America's, compared with a 26% shortfall in conventional GDP per head. Most European countries' leisure-adjusted GDP has grown faster than the standard measure over the past few decades, as hours worked have declined.

Europeans, don't relax

GDP is clearly not the best indicator of well-being, but the OECD concludes that for most purposes it is the best that is available on a timely basis. However, GDP needs to be complemented by other measures to give a fuller picture. The OECD takes comfort from the fact that most alternative measures yield similar international rankings to GDP per head. It is true that neither the adjustment for inequality nor that for leisure alone overturns America's economic superiority. However, if both adjustments were made, then on certain assumptions, the gap between the United States and several European countries could vanish.

This does not mean that Europe can afford to abandon economic reforms. Leisure time is valuable, but it will not pay for future pensions. Nevertheless, the OECD is to be congratulated for being the first mainstream organisation to challenge the conventional GDP numbers. Its task now is to encourage governments to start producing more relevant statistics.

Economics focus

Beyond irrelevance

Feb 9th 2006
From The Economist print edition

Why companies' financial structure matters after all

"IRRELEVANCE theory" contains one of the most startling conclusions in economic thought. In two papers, published in 1958 and 1963, Franco Modigliani and Merton Miller argued that a firm's financial structure—its split between equity and different sorts of debt, its dividend policy and so on—made no difference to its total value. Financial structure merely affected how the corporate pie was shared out; it had no effect on the size of the pie itself. Managers and owners should therefore waste no time agonising about gearing, dividends and such like, and instead devote themselves to maximising the value of their firms.

This insight helped win Modigliani and Miller Nobel prizes in economics (although two such giants would surely have earned them without it). Unfortunately, it also set back for a generation the study by economists of corporate finance. The problem is not that irrelevance theory is wrong but that it is true only in circumstances so rare that they are the exception rather than the rule: that the choice of financial structure does indeed affect the value of a firm.

That choices about debt, equity and so forth do matter is the underlying theme of a magnificent new book, "The Theory of Corporate Finance", by Jean Tirole, of the University of Toulouse*. This is far more than the mere textbook it purports to be; it has a plausible claim to be the first truly comprehensive overview of corporate finance by an economist. Perhaps this only goes to show how slow economists have been.

Means to a different end

Mr Tirole starts not with Modigliani and Miller but with Adolph Berle and Gardiner Means, who in 1932 published a classic book documenting the separation of the ownership and control of firms in America. This separation, they found, allowed managers considerable discretion, which could be abused at the expense of owners—ie, shareholders. It is only in the past 30 years that economists have started to explore seriously the implications of these "agency costs"—the financial loss to the "principal" (the shareholders) due to the abuse of discretion by the "agent" (the manager) hired to run the firm.

In the world of Modigliani and Miller, no account was taken of agency costs. The size of the pie was taken as given, without considering whether managers were making it as big as they could. For Mr Tirole, the "premise behind modern corporate finance is that corporate insiders need not act in the best interests of the providers of the funds". Much of the innovation in corporate finance in recent decades has been based on that premise. A lot of work has gone into designing ways of enabling investors to entrust money to managers with a reasonable expectation of getting something back.

Nowadays, an understanding of agency costs is a standard tool in any economist's kit. Since they have been looking seriously, economists have identified numerous areas of potential conflict between managers and owners. Mr Tirole groups these into four categories: insufficient effort; extravagant investments; entrenchment strategies (actions, such as anti-takeover “poison pills”, that are costly to shareholders and make it harder to remove managers); and self-dealing (from legally consuming perks to promoting friends or even outright theft). Ominously, Mr Tirole notes that in recent corporate scandals self-dealing may have been prominent only because it is “somewhat easier to discover and especially demonstrate than insufficient effort, extravagant investments or entrenchment strategies”. Misbehaviour you can see is, he says, merely the “tip of the iceberg”.

At its simplest, issuing debt tackles agency problems (but does not resolve them fully) because a bond legally obliges managers to pay interest and repay the sum borrowed on specified dates. Equity is much less effective, because it carries no formal obligation to pay shareholders back. Yet in recent years much progress has been made in understanding how to reduce equity agency costs, argues Mr Tirole. Besides increasing the ratio of debt to equity in a firm's balance sheet, an idea that gained popularity in the 1980s, there are two main methods: incentives (such as share options) that align managers' and owners' interests; and better monitoring of managers.

True, neither of these is perfect. Economists, inevitably, have found that every innovation in corporate governance has costs as well as benefits. For instance, share options can encourage managers to take far bigger risks than shareholders would wish when they are under water (that is, when the exercise price of the share option is above the market price of the share). Even so, as Mr Tirole explains in great detail, economists have gained a much better grasp of which mix of incentive and monitoring is likely to work best in which circumstances.

One puzzle is why economists took so long to get there. Maybe, speculates Mr Tirole, this is because from the 1930s to 1970s they were mostly obsessed with macroeconomics and, in particular, theories of general equilibrium. These assumed that markets were perfectly competitive, free of informational asymmetries such as those identified by Berle and Means.

Although Modigliani and Miller slowed the development of economic theories of corporate finance, their work became a foundation stone of financial economics. Financial economists' starting point is the investor rather than the firm: how, they ask, can people best spread their money over a range of assets (including corporate bonds and shares)? While corporate-finance economists increasingly emphasise agency problems, many financial economists still play them down, says Mr Tirole. Would debt and equity markets work better if capital's suppliers and corporate consumers found the same theories relevant?

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* Princeton University Press, February 2006: $55; £35.95

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Award: Pam Woodall

Feb 9th 2006

Our economics editor, Pam Woodall, has been named joint winner of the 2005 Rybczynski Prize by the Society of Business Economists

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Taxonomy

Today we have naming of parts

Feb 9th 2006
From The Economist print edition

A global registry of animal species could shake up taxonomy

AP

AT THE moment, the department of entomology at London's Natural History Museum is being rearranged, by bulldozer. It isn't a bad emblem for the broader changes transforming the science of taxonomy. Walls and ceilings are being torn down, and the tatty furniture has been thrown out. Change was due, because nearly 250 years after Carl von Linné, a Swedish naturalist, invented the modern system of naming living creatures, taxonomists still have no official list of all the animals discovered so far. This makes the work of biologists, ecologists and conservationists—who rely on species names to know just what it is they are studying and conserving—more difficult than it need be.

Linnaeus, to give his familiar, Latinised name, introduced the system of binomial nomenclature in 1758 by classifying more than 10,000 species of animals and plants with two-part names, also Latinised, such as *Homo sapiens*. But so many species since then have been named in such a haphazard way that animal nomenclature is in trouble. Although Linnaeus's big idea was that each species would have one scientific name, so that scientists could know immediately what they were discussing, the lack of a single official “telephone directory” has frustrated the entire enterprise. Around 1.5m species are thought to have been described so far, but more than 6m names have been used. And despite occasional high-profile discoveries such as that of a new honeyeater on the Indonesian part of New Guinea (see picture above) by Bruce Beehler, of Conservation International, a wildlife-preservation society, most novelties are additions to the 1m-strong list of insects—a list that is already bafflingly complex and incomplete.

The result is that taxonomists must struggle long and hard to figure out whether a name has been used before and also what other, similar, animals look like. In entomology alone, relevant data may be found in any one of more than 1,000 specialised journals. No wonder such a large proportion of the world's museum specimens are labelled incorrectly. The solution, proposed by a group called the International Commission on Zoological Nomenclature (ICZN), based at the Natural History Museum, is called ZooBank.

E pluribus unum

Exactly how ZooBank would work is still under discussion. When Andrew Polaszek, the executive secretary of the ICZN, proposed the idea, it was as much a call for proposals as a blueprint. But the non-negotiable core is for an open-access, web-based system that would set out to be definitive. Anything that does not appear would be an un-species as far as taxonomy is concerned.

The new database would also link up with several existing systems, some old and some new. The oldest, at 150 years, is a catalogue of species called the Zoological Record, which is maintained in the British city of York by a firm called Thomson Zoological that makes its money by scouring the zoological literature, collating the results, and selling them. According to Nigel Robinson, the director of operations at Thomson Zoological, the record describes and collates about 17,000 species a year. But it still misses quite a few, so by joining the Zoological Record with ZooBank, Mr Robinson hopes both to help create and to gain access to a comprehensive official list of the future.

If all goes well, ZooBank would also link to databases of a less traditional nature, including ones that use molecular biology and genetics as well as good, old-fashioned anatomy to describe their contents. These range from the uBio Taxonomic Name Server, Species 2000 and Wikispecies, to GenBank, the Barcode of Life and the Tree of Life project. The result, it is hoped, will resemble a global online animal encyclopaedia.

Most taxonomists agree with the basic principle of ZooBank. There are, however, disagreements about exactly how it should work. Two of the least tractable are who gets to decide which names are chosen, if there is a dispute—and which names are unacceptable in any circumstances.

At the moment, the validity of a name depends on precedent, which has led to the unwelcome re-dubbing of familiar species on the basis of long-forgotten specimens that have come to light in the dusty corners of collections. One notorious example was the translation of a familiar dinosaur, *Brontosaurus*, into *Apatosaurus*. A more important case is *Aedes aegypti*, the mosquito that transmits yellow fever and dengue, which, to the horror and confusion of medical entomologists, was renamed *Stegomyia aegypti* on what many consider flimsy evidence.

What name a genuinely new species is given, though, is entirely up to the discoverer. Hence the existence of *Anophthalmus hitleri*, a blind cave beetle named in 1933 after Adolf Hitler. In this context, the recent naming of another beetle after the American president is hardly a hanging offence, although Mr Bush may not be flattered by the company. But when the scientific underpinning of taxonomy itself is threatened by politics, different questions arise. Last year, for example, there was a nasty row in Turkey between Kurdish and Turkish taxonomists over whose names should apply to some local animals. The Kurds accused the Turks of renaming several species to remove any trace of Kurdishness.

Another issue is the sale of animal names. This is not yet commonplace, but an interesting precedent was set last year when a Canadian gambling company bought the right to name a newly discovered species of South American monkey. Here, ZooBank could help by providing some sort of guarantee that such a precious asset will not vanish in a puff of nomenclatural smoke.

So ZooBank should deal with the naming problem. But comparisons with existing specimens are essential to make sure that any apparently new species really is new. Next month, that too should become easier when the Natural History Museum, together with its counterpart in Paris and also America's Department of Agriculture, will flick the switches on a network of remotely operated microscopes.

Today, when a taxonomist wants to view a specimen held elsewhere, he must either get it on loan, or make a trip to see it. The new system means that museum staff can set up the microscope on request to let taxonomists look at the specimen over the web. An 18th-century science, therefore, looks as though it has a surprisingly 21st-century future.

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Zebra mussels

Shells out

Feb 9th 2006
From The Economist print edition

A pest of power stations may be about to get its comeuppance

GETTING rid of alien invaders is hard. Most species die when moved out of their natural environment, but some thrive on the change and multiply to become ineradicable pests.

Enemy in sight

Few are more pesky than the zebra mussel, a freshwater bivalve from the Baltic and Black seas that has taken to the waters of North America and does several billion dollars-worth of damage a year there by clogging up power-station pipes and other industrial installations. People have tried just about every conceivable way to murder the mussels, from chilli powder to electrocution. But the only tried and tested method is to poison them with chlorine, which is bad for other wildlife in the area, and not that good for people, either, as chlorine tends to react with natural organic chemicals to form carcinogenic compounds.

David Aldridge of Cambridge University thinks he has the answer. His preferred poison is not chlorine, but potassium chloride. In high concentrations, potassium chloride is lethal (it is one of the most common ways that doctors commit suicide, because it shuts down heart-muscle activity more or less instantly). In low concentrations, though, the stuff is harmless.

Dr Aldridge's trick was to work out how to deliver potassium chloride to mussels in large doses while allowing the surplus to vanish harmlessly. He does this by encapsulating tiny lumps of the stuff in coatings made of fatty acids and putting the resulting “BioBullets” into the water flowing through pipes clogged by the molluscs. Zebra mussels feed by filtering small particles such as algae out of the water and digesting them. Dr Aldridge's bullets are the right size to get trapped in a mussel's sieve, and when the fatty-acid coat is digested the result is not a tasty meal, but a dose of poison.

The beauty of the system is that the coatings of uneaten bullets dissolve quite quickly anyway, diluting the potassium chloride in the surrounding water of whichever lake or river the pipe empties into. Other wildlife is thus unlikely to be harmed, and no noxious organochlorine compounds are formed. So, as far as zebra mussels are concerned, it seems as if Dr Aldridge has come up with the ultimate magic bullet.

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Particle physics

Faster, higher, smarter

Feb 9th 2006
From The Economist print edition

Particle physicists are gathering in Geneva for games of a different sort

WHEN the games of the XXth Winter Olympiad open in Turin on February 10th, the world's best athletes will assemble in a spirit of good-natured competition. At the same time, just across the Alps on the outskirts of Geneva, a group of the world's best physicists will be gathering at CERN, Europe's biggest particle-physics laboratory, for a bit of friendly competition of their own.

Dubbed the “LHC Olympics”, this meeting is the second of a series that brings together theoretical physicists of all stripes with some of their experimental colleagues to train for the opening of the Large Hadron Collider (LHC), CERN's newest and largest particle accelerator. The games themselves are a series of “black-box” challenges, each consisting of a realistic but simulated set of data from an accelerator experiment. Given a few months and some basic training in the computational tools of the trade, teams from universities around the world have been trying to unravel the underlying theories used to construct these data sets in time to present their results at the meeting.

The purpose of it all is to work out how best to handle the huge amount of data that the LHC will generate when it begins operating in the summer of 2007. Protons will travel around its 27km-long circular tunnel at 99.999999% of the speed of light, eventually crashing head-on inside one of four detectors and generating a shower of high-energy debris. The detectors themselves are designed to reconstruct the motion—and thus the identity—of each particle in this debris, for it is from such pieces that the fabric of reality is woven.

Over the past few decades, theoretical physicists have developed a partial understanding of that fabric known as the Standard Model. This explains all the known particles and their interactions, with the notable and thorny exception of gravity. The LHC was designed to discover the as-yet unobserved linchpin of the Standard Model, a particle called the Higgs boson that is needed to give mass to those particles which have it (some, such as photons, the particles of light, are massless).

Few physicists, however, believe that finding the Higgs will wrap their subject up. The Standard Model relies on a number of mathematical assumptions to make its predictions, and the next phase is to explain these. Many researchers hope, therefore, that the LHC will also generate evidence for any or all of several exotic theories that would provide such explanation. The most popular of these theories, called supersymmetry, holds that each known particle has a heavier doppelganger called its superpartner. Other theories posit extra dimensions beyond the familiar three of space and one of time, or even mini-black holes that would be produced by the powerful collisions in the LHC and would then evaporate in a zillionth of the blink of an eye.

With such a zoo of possibilities, disentangling the results is sure to be tricky. Often the new theories make similar predictions, even though the underlying causes of those predictions are different. Vanishing energy, for example, could be a particle sneaking off into another dimension,

or merely one that has zipped away in boring, normal spacetime without leaving a trace, because the machine is not equipped to notice it. The organisers hope the LHC Olympics will lead to a better understanding of how to tell the difference. The fruit of success, as at the real Olympics, will be gold medals. Only these medals will bear the likeness of Alfred Nobel.

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Drug addiction

A question of standards

Feb 9th 2006
From The Economist print edition

More suggestions of bad behaviour by tobacco companies. Maybe

AP

Smoke gets in your eyes

ANOTHER round has just been fought in the battle between tobacco companies and those who regard them as spawn of the devil. In a paper just published in the *Lancet*, with the provocative title “Secret science: tobacco industry research on smoking behaviour and cigarette toxicity”, David Hammond, of Waterloo University in Canada and Neil Collishaw and Cynthia Callard, two members of Physicians for a Smoke-Free Canada, a lobby group, criticise the behaviour of British American Tobacco (BAT). They say the firm considered manipulating some of its products in order to make them low-tar in the eyes of officialdom while they actually delivered high tar and nicotine levels to smokers.

It was and is no secret, as BAT points out, that people smoke low-tar cigarettes differently from high-tar ones. The reason is that they want a decent dose of the nicotine which tobacco smoke contains. They therefore pull a larger volume of air through the cigarette when they draw on a low-tar rather than a high-tar variety. The extra volume makes up for the lower concentration of the drug.

But a burning cigarette is a complex thing, and that extra volume has some unexpected consequences. In particular, a bigger draw is generally a faster draw. That pulls a higher proportion of the air inhaled through the burning tobacco, rather than through the paper sides of the cigarette. This, in turn, means more smoke per unit volume, and thus more tar and nicotine. The nature of the nicotine may change, too, with more of it being in a form that is easy for the body to absorb.

According to Dr Hammond and his colleagues, a series of studies conducted by BAT's researchers

between 1972 and 1994 quantified much of this. The standardised way of analysing cigarette smoke, as laid down by the International Organisation for Standardisation (ISO), which regulates everything from computer code to greenhouse gases, uses a machine to make 35-millilitre puffs, drawn for two seconds once a minute. The firm's researchers, by contrast, found that real smokers draw 50-70ml per puff, and do so twice a minute. Dr Hammonds's conclusion is drawn from the huge body of documents disgorged by the tobacco industry as part of various legal settlements that have taken place in the past few years, mainly as a result of disputes with the authorities in the United States.

Dr Hammond suggests, however, the firm went beyond merely investigating how people smoked. A series of internal documents from the late 1970s and early 1980s shows that BAT at least thought about applying this knowledge to cigarette design. A research report from 1979 puts it thus: “There are three major design features which can be used either individually or in combination to manipulate delivery levels; filtration, paper permeability, and filter-tip ventilation.” A conference paper from 1983 says, “The challenge would be to reduce the mainstream nicotine determined by standard smoking-machine measurement while increasing the amount that would actually be absorbed by the smoker”. Another conference paper, from 1984, says: “We should strive to achieve this effect without appearing to have a cigarette that cheats the league table. Ideally it should appear to be no different from a normal cigarette...It should also be capable of delivering up to 100% more than its machine delivery.”

None of the documents discovered by the three researchers shows that BAT actually did redesign its cigarettes in this way, and the firm denies that it did. However, BAT's own data show that some of its cigarettes delivered far more nicotine and tar to machines which had the characteristics of real smokers than to those which ran on ISO standards. In the most extreme example, in a test carried out in 1987, the “real smoking” machine drew 86% more nicotine and 114% more tar from Player's Extra Light than the ISO machine detected, although smoke intake was only 27% higher.

Regardless of how this came about, the irony is that low-tar brands may have ended up causing more health problems than high-tar ones. As one of BAT's medical consultants put it as early as 1978, “Perhaps the most important determinant of the risk to health or to a particular aspect of health is the extent to which smoke is inhaled by smokers. If so, then deeply inhaled smoke from low-tar-delivery cigarettes might be more harmful than uninhaled smoke from high-tar cigarettes.” The firm, meanwhile, points out that the ISO test has been regarded as unreliable since 1967, and says its scientists have been part of a panel that is working on a new ISO standard.

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The Richard Casement internship

Feb 9th 2006
From The Economist print edition

We invite applications for the 2006 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words that they think would be suitable for publication in the Science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. Applications must reach us by February 25th. They should be sent by e-mail to casement@economist.com

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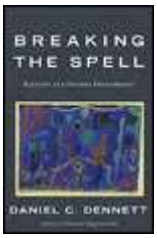
Religion

Let's cool down and look at this rationally

Feb 9th 2006
From The Economist print edition

A modest suggestion, in intemperate times, for a more temperate approach to religion

Breaking the Spell: Religion as a Natural Phenomenon
By Daniel C. Dennett



Viking; 464 pages; $25.95.
Penguin/Allen Lane; £25

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TOWARDS the end of his elegant, sharp-minded essay on the need to study religion in a

dispassionate way (in other words, just as anything else should be studied), Daniel Dennett teasingly asks his readers whether they have heard of a people called the Yahuuz. Among these exotic folk, he informs us, people who reach the age of 80 are expected to commit suicide, and their remains are then gobbled up by the whole tribe. What we would regard as child pornography, they call good clean fun; they also perform, in hilarious public rituals, the things that civilised folk do in a lavatory. If readers are disgusted, Mr Dennett goes on to suggest, they may finally have glimpsed what many Muslims feel about western countries where people drink alcohol, wear skimpy clothes and ignore traditional ideas about the family.

Had he been writing today, in a month when Muslims and Christians are engulfed in passionate conflict over the ridiculing of the Prophet Muhammad in a European cartoon, Mr Dennett, a philosophy professor at Tufts University, might have used a different metaphor or parable to convey the difficulties of discussing religion across high cultural barriers. Just as a set of rules and rituals can seem self-evidently horrific to some people and perfectly natural to others, the symbols of religion—holy persons, holy artefacts or holy buildings—can evince reactions ranging from awe to repulsion to indifference among people who in other contexts would find little to disagree over.

But, memorable as it is, the tale of the Yahuuz goes against the grain of Mr Dennett's main argument, which is that religious belief—especially in the United States—is often sheltered from the cut and thrust of intellectual argument and scientific scrutiny, and it should not be.

As the writer argues, there is now a huge range of intellectual tools which ought to be used to understand the phenomenon of religion better: from psychology to neuroscience (studying the parts of the brain where religious experience seems to occur) to genetics to social and cultural history. As a passionate neo-Darwinian, Mr Dennett is particularly interested by the “usefulness” of religion in evolutionary terms. And as a rigorous philosopher, he sets about deconstructing, in a few devastating strokes, some of the beliefs that people have held about the “personal” nature of reality.

In a world where many of the forces that determine human life seem unpredictable, frightening and capricious, it is natural—as Mr Dennett reminds us—to attribute personal qualities to those forces. But in everyday life, humans (and other animals) continually revise their beliefs about which agencies are personal and which are not. A noise outside the house may be an intruder, or it may be snow sliding off the roof—in the light of experience, we can tell which theory is right. Just as we use trial and error to test and revise our assumptions in small matters, we should bring empirical evidence to bear on the beliefs we hold about ultimate things.

In fact, as Mr Dennett points out, the situation in modern America is almost the opposite of that. The conventional view is that faith, in general, is something self-evidently desirable whose contents should not be scrutinised too closely. He might have added that conventional American wisdom also considers it in poor taste to draw attention to the fact that these generally desirable systems of belief hold tenets which contradict one another.

And this leads to odd results. Take, for example, the difference between believing that Jesus Christ was 1) God incarnate, 2) a person who wrongly claimed to be the Messiah, or to whom a claim to be the Messiah was falsely ascribed, or 3) a uniquely inspired prophet who will return at the end of time. This is not a trivial difference, especially from the point of view of anyone who holds one of those three views. Yet for historical and cultural reasons, modern American manners require that such differences are played down—though there are those who hold that believers in the third view (ie, Muslims) are doomed to clash with believers in the first two, ie, Christians and Jews.

How would such differences be handled in Mr Dennett's clear-eyed but courteous world? One benefit of honesty about religion, he suggests, is that children could be taught objectively about

the harm and good that faith has done, both as an inspiration to social reform and altruism, and as a slogan that can inspire hatred.

But that still would not make communications between the Yahuuz and others easy. The conclusion Mr Dennett draws from his own anecdote is that Yahuuz and non-Yahuuz (ie, any pair of groups with vastly different thresholds of horror and cultural assumptions) should not shy away from dialogue with each other. In such a dialogue, both sides should be prepared to examine and revise their own assumptions. That sounds very sensible, but in the light of the passions now raging in the world, very improbable.

Breaking the Spell: Religion as a Natural Phenomenon.
By Daniel C. Dennett.
Viking; 464 pages; $25.95.
Penguin/Allen Lane; £25

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The Arab-Israeli conflict

Discrepant historical rhythms

Feb 9th 2006
From The Economist print edition

MANY of the participants have now dissected the failure of Bill Clinton's heroic effort six years ago to make peace between Yasser Arafat and Israel's Ehud Barak. The longest book to date has come from Dennis Ross, the senior American official involved. The most profound may be this beautifully written account by Mr Barak's foreign minister, Shlomo Ben-Ami, a Moroccan-born historian who became a politician. It should be compulsory reading for anyone who feels a partiality to one side or the other, though it will not be a comfortable read: Mr Ben-Ami is unsparing in his criticisms of both sides.

Scars of War, Wounds of Peace: The Israeli-Arab Tragedy
By Shlomo Ben-Ami

Oxford University Press; 354 pages; $30.
Weidenfeld & Nicolson; £20

Buy it at
Amazon.com
Amazon.co.uk

Mr Ben-Ami does not focus only on the Clinton initiative. He places that episode in the broad context of the conflict, employing a bluntness about his own country which, if he were a western journalist and not a former Israeli foreign minister, would undoubtedly have Israel's supporters in America rushing to denounce him.

For example, Mr Ben-Ami has no time for the myth that early Zionism posed no threat to the national aspirations of Palestine's Arabs. Indeed, the Arab revolt against the British in 1936-39—the real first *intifada*—confirmed the instinct of the Jewish leadership in Palestine that war with the Arabs was inevitable. But whereas the Arabs clung to maximal positions, he says, the Zionists planned carefully for their inevitable war while understanding the value of tactical compromises.

The UN partition resolution of 1947 was, says Mr Ben-Ami, the crowning achievement of one of the most successful national enterprises of the 20th century. The Arabs were defeated by the extraordinary capacity of the Zionists to combine diplomatic savoir faire with military means—and considerable brutality. The Palestinians faced “a ruthless Israeli army whose path to victory was paved not only by its exploits against the regular Arab armies, but also by the intimidation, and at times atrocities and massacres, it perpetrated against the civilian Arab community.” But in 1948 and ever since, Israel's hubris of victory was combined with a no less genuine, paradoxical and “almost apocalyptic” fear of annihilation. Paradoxical, but not, says Mr Ben-Ami, irrational. For whatever the concrete balance of military power in this conflict, Israel is rightly aware of the immense Arab hinterland that could afford one defeat after another and still be ready for the next round.

Mr Ben-Ami argues that a failure of leadership has throughout been a major cause of the calamity that has befallen the Palestinians. This was the case under the leadership of the fanatical Haj Amin el-Husseini in the 1940s and under Arafat from the 1960s onwards. But Israel's leaders also failed. The great victory of 1967 ushered in an “orgy of political drunkenness and military triumphalism [that] blinded the eyes of Israel's leaders from seeing the real, not the Messianic, opportunities that her lightning military exploits opened for her.” After the defeat, the Arabs might have made

peace in return for the 1948 borders they had hitherto rejected. But now an intoxicated Israel wanted more, and the failure to make peace led both to a revival under Israeli occupation of a fierce Palestinian nationalism and the birth, under the spell of the six-day victory, of a Messianic national-religious Jewish expansionism.

With contrition such as this on the Israeli side, why did Mr Clinton's peacemaking fail? While admitting to Israel's negotiating mistakes and the arrogance of Mr Barak, Mr Ben-Ami says that at Camp David, and even more in the later Clinton “parameters”, a respectable two-state deal was there for the taking. But Arafat—“elusive, non-committal, the master of double talk”—was not willing to grasp it. In part, argues Mr Ben-Ami, this reflected a wider Palestinian preoccupation with vindication and justice, at the expense of a pragmatic search for a solution.

The book ends with Ariel Sharon's Gaza withdrawal but before the victory of the Islamists of Hamas in the Palestinians' election. Mr Ben-Ami concludes by arguing that it is time for both parties to realise that to continue to insist on the complete satisfaction of their respective dreams and presumed rights will lead them both to perdition. The Hamas victory suggests that such a realisation remains distant. The conflict, he remarks, has long been plagued by “discrepant historical rhythms”. At the very moment Israel is showing small signs of turning away from post-1967 Messianism and rediscovering a sense of its limits, the Palestinian side has on the face of it reverted to the self-defeating maximal demands of the 1940s. Folly marches on.

Scars of War, Wounds of Peace: The Israeli-Arab Tragedy.
By Shlomo Ben-Ami.
Oxford University Press; 354 pages; $30. Weidenfeld & Nicolson; £20

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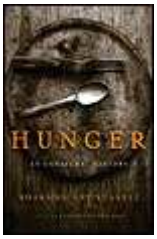
Hunger

Starving, or making a point

Feb 9th 2006
From The Economist print edition

WHEN most of us think of hunger, we probably think of our own mid-morning longing for lunch or, if we are generous, of starving African children. Sharman Apt Russell, in her elegant meditation on hunger, reflects on both, but also on the many ways in which hunger can be a deliberate statement. Mystics, rebels, feminists, exhibitionists: all have used hunger as a way to make a point.

Hunger: An Unnatural History
By Sharman Apt Russell



Basic Books; 262 pages; $23.95 and £14.50

Buy it at
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Amazon.co.uk

In an age of obesity, this is a clever notion and Ms Apt Russell scoops every morsel of interest from her subject. She also writes beautifully. Not surprisingly, this produces a feast. But it is a feast of hors d'oeuvres, without a substantial main course. There is no over-arching argument to bind together passages as different as, say, a description of the way the human body responds to a long period without food and an account of the connections between sanctity and self-starvation. As Winston Churchill once said, “This pudding has no theme.”

For the multitude who prefer the starters to the entrée, this will not matter. They will read some astonishing stories. There is, for instance, the tale of the doctors in the Warsaw ghetto who turned the horrors of starvation into medical research by studying the impact of lethal hunger on their fellow Jews. Their work laid the foundations for the meticulous study of how extreme hunger affects body and mind.

Across the Atlantic, in the last year of the second world war, 36 volunteers took part in an experiment in Minnesota involving six months of closely observed near-starvation. The worst part was the process of rehabilitation. Eager to emulate conditions in the stricken countries of post-war Europe, the researchers wanted to discover how little food a starving man needed in order to recover. Their guinea- pigs hated it; one even chopped off fingers in protest. But their transition from apathy to aggression was observed by aid workers among the recovering hungry of Europe.

Hunger breeds hideous behaviour. In Africa, a hunger-prone tribe lives in selfishness and conflict, each family member competing with others for food. In China, a proverb, “Swap child, make food”, referred to the practice in periods of extreme famine of swapping a daughter's corpse with that of a neighbour's and boiling it into soup. But hunger is also a potent weapon. Mahatma Gandhi undertook 17 public hunger-strikes during his lifetime, using them to advance his vision of tolerance and religious diversity. He also used self-imposed hunger to bully his family, fasting “against” a married woman who had seduced his 20-year-old son, until the boy agreed not to marry for 15 years and the woman cut her hair in remorse.

Among this smorgasbord of stories, one of the most endearing is a description of Ms Apt Russell's own experiment with self-starvation. She yearned for the nirvana described by those who fast for

seven days and more: “They feel special...They feel light. For moments at a time, they forget they have four limbs, a form and a body.” Ms Apt Russell merely felt cold and “smelled like paint thinner”. When she got up too quickly, she fell over. After four days of this, “I was bored. So I ate an orange.” That's better.

Hunger: An Unnatural History.
By Sharman Apt Russell.
Basic Books; 262 pages; $23.95 and £14.50

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New fiction

Being and nothingness

Feb 9th 2006
From The Economist print edition

THIS new novel by James Lasdun opens with a drenching in red wine and ends with the spilling of blood. The perpetrator, in the first instance, is a former East German protester who got to the West through *freikauf*, a barter arrangement popular in the 1970s and early 1980s, that involved selling dissident flesh for hard currency. The second perpetrator is her husband. But it is the victim in both cases, Stefan Vogel, who is the hero of this ferociously chilling exposé of human fantasy and corruptibility, which came out in America last October and is now published in Britain.

Seven Lies
By James Lasdun

Norton; 204 pages; $23.95.
Jonathan Cape; £14.99

Buy it at
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Amazon.co.uk

Stefan is the son of a cast-off diplomat who is sacked from the East German foreign service for a minor misdemeanour just as the Vogel family was about to be posted to New York and escape the dreariness of East Berlin. His mother is a one-time Silesian aristocrat who aspires to be regarded as an intellectual and an aesthete to help make up for the knowledge that she has come down in the world.

Ignorant of the burden of expectation placed upon him, Stefan allows, indeed almost wills, himself to be trapped into reading out loud before a gathering of his mother's intellectual friends some poetry that he claims to have written himself. Later he falls in with a circle of actors and artists to whom he boasts, untruthfully, that his poetry is about to be published in *Sinn und Form*, a highly respected literary journal.

In order to avoid being caught out in this lie, Stefan asks his uncle, who works in the office of the Chief of the People's Police, to intervene and ensure that some of Stefan's poems are indeed published in the next issue. That sort of thing used to happen all the time in East Germany, but of course at a price. Stefan becomes a Stasi informer. And although he eventually escapes Berlin, it is only a question of time before the past catches up with him.

Mr Lasdun's novel is not long, but the imaginativeness with which he explores the politics of expectation and failure runs deep. As in his earlier novel, “The Horned Man”, an *Economist* book of the year in 2002, “Seven Lies” combines the knuckle-whitening tension of a thriller with literary wit and the precision of a surgeon seeking to tease out rotten flesh. Definitely a novel to be admired.

Seven Lies.
By James Lasdun.
Norton; 204 pages; $23.95.
Jonathan Cape; £14.99

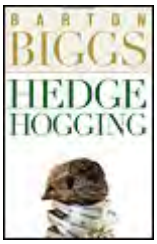
Hedge funds

A desperate, frantic adventure

Feb 9th 2006
From The Economist print edition

Alamy

Hedgehogging
By Barton Biggs



Wiley; 320 pages; $26.95 and £16.99

Buy it at
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THREE years ago, and just two years after stating that “hedge-fund mania now grips the US and Europe” and “is rapidly assuming all the classic characteristics of a bubble”, Barton Biggs, then aged 70, started a hedge fund of his own. But if irrational exuberance finally captured Mr Biggs—who had spent the previous 30 years at Morgan Stanley, where he founded the research department and chaired the investment management division—it does not show. In “Hedgehogging”, his engaging memoir-cum-treatise on the “never-ending search for investment acorns”, Mr Biggs never lets the reader forget that even for the greatest investors, disaster may be but a trade away.

This is a book that will convince most readers that investing is best left to the professionals. It will also leave them feeling not terribly reassured by that conclusion. The professional investors, the “hedgehogs”, whom Mr Biggs describes, are by and large obsessive, intensely competitive, damaged people, albeit that the best of them are also intelligent, curious, widely-read sophisticates (like Yale-educated, wannabe-novelist Mr Biggs himself).

The book concludes with a chapter on John Maynard Keynes, whom Mr Biggs reckons was a hedge-fund pioneer long before Alfred Jones in the 1940s gave the name to the sort of fund that can both buy and sell short (selling short means selling borrowed assets in the hope of buying them back later at a lower price). Keynes made and lost a fortune three times; he suffered fits of depression and attacks of nerves; he could never resist an intriguing story about a stock. He was also someone “who sometimes walked across the Cambridge campus pumping (urinating) and who was famously gay, lecherous and notoriously promiscuous.” In case you were wondering, Mr Biggs reckons that although there “are many brilliant and bizarre characters in today's hedge-fund world, Keynes surpasses them all.”

The author's other bizarre investors are often disguised (thinly) with false names. This may be a legal or social necessity, but it makes for a less titillating read. A few years ago, Mr Biggs got into trouble for writing about a plumber who was too busy day-trading shares to fix his pipes, who turned out to be a figment of his imagination. But the characters in “Hedgehogging” seem real enough.

There is “Peter” who “has a stationary bicycle built into his limo so he can work out, read the paper, watch CNBC and get driven to work all at the same time.” Or “Vince”, who “thinks of himself as a prophet”, and believes that the “excesses of the 1990s have only begun to be purged, and that the secondary consequences will be a social and financial revolution that will destroy another huge chunk of paper wealth and transform society.”

Lady Thatcher's bad advice

Margaret Thatcher even puts in an appearance, dissuading Mr Biggs from getting out of Russian paper shortly before the market crashed in 1998 (he has forgiven her). Currently, Mr Biggs is bullish on emerging markets in Africa and the Middle East, and is not yet convinced that America is in the grip of a housing bubble. But, as he readily admits, he has been wrong before and will be wrong again. Indeed, Traxis Partners, his hedge fund, has already mistakenly shorted oil in May 2004 and the dollar in December 2004.

Working for a hedge fund is currently extremely fashionable, the top choice of graduating Harvard MBAs. Mr Biggs does a good job of revealing the reality behind the glamour. In 2004, 1,000 new hedge funds were formed and about 1,000 closed down, with a whimper. Despite his own long record, Mr Biggs struggled to raise money, and some of his initially keenest investors backed out as the time to pay up approached.

Chapter Five—“The Odyssey of Starting a Hedge Fund: A Desperate, Frantic Adventure”—should be compulsory reading for anyone contemplating forming their own fund. Mr Biggs found pitching for money at Morgan Stanley's fabled hedge-fund conference at The Breakers in Palm Beach an excruciating experience. “Vastly rich investors with private jets, homes in three climates and Botox-smoothed foreheads name-drop and talk about their golf games...Wealthy divorcées and widows with artificial brightness in their unpouched eyes and hard, chiselled faces and tucked stomachs and bottoms, work the crowd. Are they looking for a man or a hedge fund?”

Hedgehogging.
By Barton Biggs.
Wiley; 320 pages; $26.95 and £16.99

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Picasso and Africa

Africa's magic that transformed modern art

Feb 9th 2006 | JOHANNESBURG
From The Economist print edition

An exhibition in South Africa reveals the depth of African influence on Picasso

Out of Africa

PABLO PICASSO never went to Africa. But more than three decades after his death, his art is travelling to the continent that so deeply affected his work. “Picasso and Africa”, the most extensive exhibition of the artist's work ever assembled in the region, was due to open at the Standard Bank Gallery in Johannesburg on February 10th, and will travel to the Iziko South African National Gallery in Cape Town in April. The show, which highlights Africa's influence on Picasso's work, brings more than 80 of his paintings, drawings and sculptures together with a selection of African masks and statues similar to those that he had around him as he worked.

Picasso said that the “virus” of African art stayed with him throughout his life. He caught it in June 1907, when stumbling upon the African and Oceanic collection at the Ethnographic Museum of the Trocadéro in Paris. The fateful encounter was a revelation: “The masks were not simply sculptures like any other. Not at all. They were magical objects.” That day, he later said, he understood what painting really meant. “It is not an aesthetic process; it's a form of magic that interposes itself between us and the hostile universe, a means of seizing power by imposing a form on our terrors as well as on our desires.”

He had been working on “Les Demoiselles d'Avignon”, which became one of his most famous paintings. The visit to the museum gave him the answers he had been looking for. This portrait of five prostitutes, which he described as his first “exorcism painting”, was his first work to bear signs of African influence, with two of the women's faces shown as African masks.

Many other signs were to follow. The exhibition shows how Picasso absorbed Africa's abstract, expressive representations of faces and bodies, and made them his own. He started fragmenting and faceting the human figure, which eventually gave birth to cubism. He was later inspired by African power masks from Congo—wood carvings used by diviners to help them communicate with the spirits—which used everyday materials, such as nails and mirrors. Picasso created one of the sculptures in the exhibition, “Head of a Woman”, out of a colander and springs; nails and newspapers find their way into other works.

The show offers visitors a glimpse into Picasso's genius at work. Many of the pieces exhibited are drawings, sculptures and studies that the artist kept in his studio and which document and dissect his experiments with a new art form. His fascination for African art had turned into a collecting bug, which he fed as he wandered the flea markets of Paris and Marseilles. He gathered over 100 African statues and masks, and kept them by him. Visitors to the exhibition, surrounded by work in progress and with African artefacts beaming their magic, feel transported to his studio.

Many of Picasso's contemporaries shared his fascination with African art. Artists such as André Derain, Maurice de Vlaminck, Georges Braque and Henri Matisse were also avid collectors. In the early 20th century, France's colonial push into Africa encouraged an interest in the tales and objects from mysterious, exotic lands, which travelled back with soldiers, traders and missionaries. Picasso and his fellow avant-garde artists, who had been searching for a new artistic language to break the mould of conventional representation, were exposed to forms rich in symbols.

Africa found its way in varying degrees into their work. Yet, explains Marilyn Martin, one of the exhibition's curators, Picasso had a unique understanding of the magical and ritualistic power of African art, which influenced him far beyond form. That encounter at the Ethnographic Museum transformed his artistic vision, and with it the direction of modern art.

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Economist.com PEOPLE
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Betty Friedan

Feb 9th 2006
From The Economist print edition

Betty Friedan, campaigner for women's rights, died on February 4th, aged 85

Getty Images

ONCE upon a time, behind the door of almost every ranch house on almost every suburban street in America, a beautiful creature could be found. She wore a housecoat, sheer stockings and a turban that kept her hairstyle neat when she was dusting. Rubber gloves preserved her flawless hands as she washed the dishes after breakfast. Her husband's homecoming was welcomed every day with new recipes from the *Ladies' Home Journal* and, after lights out, complaisant sex.

She had never been to college or, if she had, put her intelligence aside. Her life was to ferry children in the station wagon, make peanut-butter sandwiches, choose new drapes, do the laundry, arrange flowers. At eleven in the morning she would open her enormous refrigerator, cut a slice of pastel-frosted cake and wash down, with coffee, the pills that kept her smiling.

For almost a decade, in the 1950s, Betty Friedan's life was much like this. In her rambling house in Grandview-on-the-Hudson, New York, she brought up three children, cooked meals for her theatre-producer husband and “messed about” with home decoration. Obviously, she did not work in the proper sense of the word. She was a wife and mother and, as a woman, was happy to be nothing else.

One glance at Mrs Friedan, though, suggested that matters were more complicated. Short, stocky, with an enormous nose and hooded eyes, she was far from the sweet Bambi creature promoted in womens' magazines. Argument-wise, she could give as good as she got, complete with smashing crockery and the whole gamut of screams. She had majored in psychology and won a research

fellowship at Berkeley, though she gave it up when her boyfriend felt overshadowed. At college she had gone, dressed in twinset and pearls, to a squalid New York office to try to join the Communist Party. For years she had been a left-wing journalist, writing about race and sex discrimination for union news-sheets, and she had fearlessly gone on working after marriage until, on her second pregnancy, she had been fired in favour of a man.

In Grandview-on-the-Hudson, her radicalism buried, Mrs Friedan asked: “Is this all?” Despite her education she was doing no better than her mother, whose misery had filled their nice house in Peoria with temper and recrimination. Her father, once a button-hawker, had risen to own a jeweller's shop; her mother's creativity began and ended at the front yard. Most women, Mrs Friedan believed, felt the same. In 1957 she surveyed 200 classmates from Smith College, now housewives, most desperate; but when she catalogued their despair in an article, no women's magazine would publish it. Mrs Friedan determined to write a book, and in 1963 threw a firebomb into American society whose effects are still reverberating.

“The Feminine Mystique” was rambling and badly written, but it identified precisely why women were miserable. Oddly enough, since Mrs Friedan had been a keen Freudian at college, much of the problem lay with Freud, whose theories were now so popular. He had thought of women as inferiors, racked with penis envy, whose only route to fulfilment lay through men. Garbage, cried Mrs Friedan. Women needed simply to be treated as equals and freed to become themselves.

Black eyes under make-up

Grateful letters poured in from women readers. Critics, mostly but not merely male, spluttered that she was a danger to the state and a proof of the folly of sending girls to college. But women now had the political wind behind them. Mrs Friedan got busy, co-founding in 1966 the National Organisation for Women (NOW) campaigning for equal pay, maternity leave, abortion choice and decent child care, fighting for the still unpassed Equal Rights Amendment and, in 1970, celebrating 50 years of women's suffrage by leading the Women's Strike for Equality, some 50,000 souls, through New York City.

Much was achieved, especially on abortion law, but it was not plain sailing. Mrs Friedan's sharp tongue made enemies everywhere. She rapidly fell out with the daft fringe of the women's movement, the bra-burners and ball-breakers and militant lesbians (the Lavender Menace, as she called them), who wanted all-out war. The impatient disliked her incrementalist approach; the class-conscious condemned her for rooting the “woman problem” in the pampered white suburbs, rather than in ghettos and factories.

Part of the difficulty was that she loathed political correctness, gender politics and the gender studies that came to clutter the curriculums of American universities. She also approved of marriage and refused to hate men. Though she claimed her own husband abused her, giving her black eyes which she hid under make-up (in 1969, she divorced him), she insisted that men were victims of women's frustrations as much as women were. This was less a sexual problem than an economic one. It would be solved with equal work, worth and incomes.

When Mrs Friedan died, that Utopia was still distant. But at least she had made sure that post-war America's Ideal Woman was buried at some suburban crossroads, her hair still unmussed, and with a stake through her perfectly calibrated heart.

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Overview

Feb 9th 2006
From The Economist print edition

Unemployment in **America** fell to 4.7% in January, the lowest rate since July 2001. Companies (not including farms) added 193,000 workers to their payrolls, after adding 140,000 in December and 354,000 in November. But it was not all good news. Productivity, as measured by output per hour, fell at an annual rate of 0.6% in the fourth quarter, the first drop since the first quarter of 2001. Workers' compensation—including wages, taxes and employers' contributions to benefits—failed to keep pace with inflation for the third quarter in a row.

Both consumer prices and retail sales picked up in the **euro area**, making it more likely that the European Central Bank will raise interest rates next month. Annual inflation was 2.4% in January, up from 2.2% the month before. The volume of retail sales grew by 0.8% in the year to December.

Germany's latest economic figures belie the optimism reported by businessmen. Industrial production fell by 0.5% in December, its second monthly fall in a row, although production was still 3.4% higher than the year before. Orders received by manufacturing firms fell for the first time in four months.

In **Britain** industrial production edged up by 0.2% in December, but it was still 2.7% below the level it had reached a year earlier.

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Output, demand and jobs

Feb 9th 2006
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest	qtr*	2005	2006	latest		latest		latest		year ago
Australia	+ 2.6	Q3 + 0.6	+ 2.5	+ 3.1	+ 1.3	Q3	+ 1.9	Q4	5.3	Jan	5.1
Austria	+ 1.8	Q3 + 2.3	+ 1.9	+ 2.1	+ 2.8	Nov	+ 1.3	Oct	5.1	Jan	5.0
Belgium	+ 1.1	Q3 + 1.7	+ 1.4	+ 2.0	– 1.2	Nov	nil	Nov	12.9	Dec†	12.8
Britain	+ 1.7	Q4 + 2.4	+ 1.7	+ 2.1	– 2.7	Dec	+ 4.0	Dec	5.0	Nov††	4.7
Canada	+ 2.8	Q3 + 3.6	+ 2.9	+ 3.2	+ 1.5	Nov	+ 4.0	Nov	6.5	Dec	7.0
Denmark	+ 4.8	Q3 + 5.7	+ 3.3	+ 2.8	+ 5.5	Dec	+ 4.8	Dec	5.1	Dec	6.1
France	+ 1.8	Q3 + 2.8	+ 1.6	+ 2.0	+ 1.3	Nov	+ 2.1	Dec	9.5	Dec	10.0
Germany	+ 1.4	Q3 + 2.5	+ 1.1	+ 1.7	+ 3.4	Dec	– 1.6	Dec	11.3	Jan§	11.5
Italy	+ 0.1	Q3 + 1.1	+ 0.1	+ 1.2	+ 0.4	Nov	+ 0.4	Nov	7.5	Sep	7.9
Japan	+ 2.9	Q3 + 1.0	+ 2.6	+ 2.5	+ 3.8	Dec	+ 0.9	Nov	4.4	Dec	4.5
Netherlands	+ 1.3	Q3 + 2.5	+ 0.9	+ 1.9	+ 1.4	Dec	+ 4.0	Nov	6.3	Dec**	6.7
Spain	+ 3.5	Q4 + 3.6	+ 3.4	+ 3.0	+ 0.9	Dec	nil	Dec	8.5	Dec	10.3
Sweden	+ 3.4	Q3 + 3.9	+ 2.6	+ 3.2	+ 2.7	Dec	+10.7	Dec	5.4	Dec†	5.3
Switzerland	+ 2.3	Q3 + 4.3	+ 1.8	+ 2.2	+ 2.8	Q3	+ 2.2	Nov	3.9	Jan†	4.1
United States	+ 3.1	Q4 + 1.1	+ 3.6	+ 3.3	+ 2.8	Dec	+ 4.4	Dec	4.7	Jan	5.2
Euro area	+ 1.6	Q3 + 2.6	+ 1.4	+ 1.9	+ 2.6	Nov	+ 0.8	Dec	8.4	Dec	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.9	Q3 +12.1	na	na	– 1.4	Dec	+ 5.1	Nov	8.4	Dec	8.6
Greece	+ 3.8	Q3 na	na	na	+ 0.9	Nov	+ 1.6	Nov	9.7	Q3	10.1
Iceland	+ 4.0	Q3 na	na	na	na		na		1.5	Nov†	2.6
Ireland	+ 4.8	Q3 + 1.3	na	na	+14.8	Nov	+ 3.9	Nov	4.3	Jan	4.2
Luxembourg	+ 3.1	Q1 na	na	na	+ 3.3	Oct	+ 0.2	Dec	5.0	Dec	4.5
New Zealand	+ 2.0	Q3 + 0.2	na	na	– 2.7	Q3	+ 4.9	Q3	3.6	Q4	3.6
Norway	+ 3.1	Q3 + 3.2	na	na	+ 2.6	Dec	+ 3.3	Dec	4.5	Dec**	4.4
Portugal	+ 0.2	Q3 – 3.7	na	na	+ 5.1	Dec	+ 1.5	Dec	7.7	Q3†	6.8

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Sep-Nov; claimant count rate 2.9% in Dec.
§EU harmonised rate 9.3% in Nov. **Oct-Dec. ‡Sep-Nov.

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Prices and wages

Feb 9th 2006
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2005	The Economist poll consumer prices forecast 2006	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.7	+ 2.9	+ 4.8	Q4	+ 8.2	+ 6.1	Q3	+ 3.5
Austria	+ 1.6	Dec	+ 2.9	+ 2.3	+ 1.9	+ 1.7	Jan	+ 4.7	+ 2.4	Dec	+ 2.0
Belgium	+ 2.6	Jan	+ 2.3	+ 2.7	+ 2.2	+ 2.4	Dec	+ 5.3	+ 2.3	Oct	+ 2.4
Britain	+ 2.0	Dec*	+ 1.6	+ 2.1	+ 2.0	+ 2.4	Dec	+ 2.9	+ 3.4	Nov†	+ 4.3
Canada	+ 2.2	Dec	+ 2.1	+ 2.3	+ 2.2	+ 2.5	Dec	+ 3.6	+ 1.5	Nov	+ 2.6
Denmark	+ 2.2	Dec	+ 1.2	+ 1.8	+ 1.9	+ 4.6	Dec	+ 2.7	+ 2.8	Q3	+ 2.9
France	+ 1.5	Dec	+ 2.1	+ 1.8	+ 1.7	+ 3.1	Dec	+ 3.0	+ 3.2	Q3	+ 2.9
Germany	+ 2.1	Jan	+ 1.6	+ 2.0	+ 1.7	+ 2.4	Dec	+ 3.8	+ 0.2	Nov	− 0.5
Italy	+ 2.2	Jan	+ 1.9	+ 2.1	+ 2.1	+ 4.1	Dec	+ 4.2	+ 2.3	Dec	+ 3.3
Japan	− 0.1	Dec	+ 0.2	− 0.2	+ 0.3	+ 2.2	Dec	+ 1.9	+ 1.3	Dec	+ 0.8
Netherlands	+ 1.3	Jan	+ 1.5	+ 1.5	+ 1.6	+ 5.6	Dec	+ 5.1	+ 1.4	Jan	+ 0.7
Spain	+ 4.2	Jan	+ 3.1	+ 3.4	+ 3.2	+ 5.2	Dec	+ 5.0	+ 1.9	Q3	+ 2.2
Sweden	+ 0.9	Dec	+ 0.4	+ 0.6	+ 1.5	+ 6.4	Dec	+ 2.0	+ 3.3	Nov	+ 2.4
Switzerland	+ 1.0	Dec	+ 1.3	+ 1.2	+ 1.1	+ 1.1	Dec	+ 1.7	+ 0.9	2004	+ 1.4
United States	+ 3.4	Dec	+ 3.3	+ 3.4	+ 2.9	+ 5.7	Dec	+ 4.4	+ 3.3	Jan	+ 2.6
Euro area	+ 2.4	Jan	+ 1.9	+ 2.2	+ 2.0	+ 4.6	Dec	+ 3.5	+ 2.2	Q3	+ 1.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.0	Dec	+ 0.4	na	na	+ 5.2	Dec	+ 0.7	+ 3.6	Q3	+ 4.0
Greece	+ 3.6	Dec	+ 3.1	na	na	+ 8.3	Dec	+ 2.9	na		na
Iceland	+ 4.4	Jan	+ 4.0	na	na	+ 3.9	Dec	+ 5.9	+ 7.2	Dec	+ 6.0
Ireland	+ 2.5	Dec	+ 2.6	na	na	+ 3.5	Dec	− 1.6	+ 3.5	Q3	+ 4.7
Luxembourg	+ 2.5	Dec	+ 2.2	na	na	+ 1.9	Nov	+15.6	+ 4.8	Oct	− 2.3
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.1	Q3	+ 2.5	+ 3.1	Q4	+ 2.5
Norway	+ 1.8	Dec	+ 1.1	na	na	+24.3	Dec	+ 9.7	+ 2.6	Q3	+ 4.3
Portugal	+ 2.6	Dec	+ 2.5	na	na	+ 3.9	Dec	+ 4.7	− 0.4	Dec	− 1.8

*RPI inflation rate 2.2% in Dec. †Sep-Nov.

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Economic forecasts

Feb 9th 2006
From The Economist print edition

February averages (previous month's, if changed)

	Real GDP, % change				Consumer prices % increase		Current account % of GDP	
	Low/high range		average					
	2005	2006	2005	2006	2005	2006	2005	2006
Australia	2.4/2.7	2.8/3.7	2.5 (2.7)	3.1 (3.2)	2.7 (2.8)	2.9	-5.9	-5.3
Austria	1.8/2.0	1.8/2.4	1.9 (1.8)	2.1 (2.0)	2.3	1.9	nil	0.1 (-0.1)
Belgium	1.4/1.5	1.7/2.3	1.4	2.0 (1.9)	2.7 (2.5)	2.2 (2.1)	1.8 (2.2)	2.0 (2.2)
Britain	1.6/1.8	1.7/2.4	1.7	2.1	2.1	2.0	-2.0 (-2.1)	-2.3 (-2.2)
Canada	2.8/3.0	2.7/3.6	2.9	3.2 (3.1)	2.3	2.2 (2.3)	1.9 (1.8)	1.8 (1.6)
Denmark	3.0/3.5	2.4/3.3	3.3 (3.0)	2.8	1.8	1.9	3.2 (2.9)	3.0 (2.8)
France	1.5/1.7	1.6/2.2	1.6 (1.5)	2.0 (1.9)	1.8 (1.9)	1.7	-1.3 (-1.2)	-1.2 (-1.0)
Germany	0.9/1.2	1.5/1.9	1.1	1.7	2.0	1.7	4.0 (3.9)	3.8
Italy	0.1/0.2	1.0/1.5	0.1 (0.2)	1.2 (1.3)	2.1	2.1	-1.5	-1.4
Japan	2.4/2.7	1.6/3.2	2.6 (2.5)	2.5 (2.4)	-0.2	0.3	3.5	3.6 (3.4)
Netherlands	0.7/1.1	1.6/2.4	0.9 (0.8)	1.9	1.5	1.6 (1.5)	5.0 (4.1)	5.0 (4.2)
Spain	3.3/3.4	2.8/3.4	3.4	3.0	3.4	3.2 (3.1)	-6.7 (-6.5)	-6.9 (-6.8)
Sweden	2.4/2.7	3.0/3.5	2.6	3.2 (3.1)	0.6 (0.5)	1.5	7.0	6.8 (6.7)
Switzerland	1.5/2.0	1.7/2.7	1.8	2.2 (2.1)	1.2	1.1	13.5 (13.3)	13.4 (12.7)
United States	3.5/3.7	2.8/3.9	3.6	3.3	3.4	2.9	-6.5	-6.6
Euro area	1.3/1.5	1.8/2.2	1.4	1.9	2.2	2.0	-0.1 (nil)	-0.1 (nil)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, J.P. Morgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. Since this is the last month in which we show estimates for 2005, we have also set out how current estimates for the year compare with forecasts that were made 12 months ago. Japan did much better than expected in 2005, growing by 2.6% rather than 1.6%. Italy did a lot worse than was forecast 12 months ago, growing by 0.1% rather than 1.4%. The euro area grew by 1.4%, a bit less than the 1.6% that was expected last February. America grew by 3.6% rather than the 3.5% forecast a year ago.

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Money and interest rates

Feb 9th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Feb 8th 2006) 3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+ 8.1	+ 9.1	Dec	5.62	5.57	5.19	5.29	5.29	6.27
Britain	+ 4.6	+12.6	Dec	4.55	4.84	4.28	4.19	4.47	5.14
Canada	+11.1	+ 7.7	Dec	3.57	2.46	4.00	4.23	4.18	5.35
Denmark	+19.9	+14.7	Dec	2.58	2.19	2.92	3.46	3.50	4.97
Japan	+ 5.3	+ 1.9	Jan	0.03	0.02	0.31	1.57	1.37	1.66
Sweden	+ 2.3	+ 9.9	Dec	1.93	1.97	2.50	3.43	3.60	3.38
Switzerland	+ 5.4	+ 5.6	Dec	1.06	0.75	1.60	2.18	1.96	2.21
United States	- 0.1	+ 7.8	Dec	4.60	2.60	4.64	4.59	3.97	5.47
Euro area†	+11.3	+ 7.3	Dec	2.58	2.14	2.92	3.47	3.41	3.98

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.68%, Japan No. 276 1.57%. Central bank rates: US fed funds 4.50%, ECB refinancing 2.25%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, J.P. Morgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 9th 2006
From The Economist print edition

2000=100

	Jan 31st	Feb 7th*	% change on one month	% change on one year
Dollar index				
All items	156.8	159.2	+ 7.6	+26.6
Food	137.2	136.7	+ 4.7	+15.9
Industrials				
All	182.0	188.3	+10.5	+38.6
Nfa†	148.9	151.5	+ 7.5	+18.9
Metals	200.1	208.4	+11.7	+48.3
Sterling index				
All items	133.7	138.5	+ 9.0	+34.8
Euro index				
All items	119.4	123.0	+ 8.5	+35.0
Yen index				
All items	170.3	174.4	+11.0	+41.2
Gold				
$ per oz	569.75	556.65	+ 2.8	+35.0
West Texas Intermediate				
$ per barrel	67.77	62.90	− 0.7	+38.5

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 9th 2006
From The Economist print edition

Market indices

	Feb 8th	2005-06 high	2005-06 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,777.0	4,903.9	3,905.5	– 2.6	– 2.6	+17.9	+11.1
Austria (ATX)	3,982.3	4,035.5	2,415.0	– 1.3	– 1.3	+63.8	+44.0
Belgium (Bel 20)	3,775.0	3,781.3	2,958.8	nil	– 0.2	+28.7	+13.2
Britain (FTSE 100)	5,725.1	5,801.6	4,783.6	– 1.3	–17.4	+18.9	+ 7.9
Canada (Toronto Composite)	11,735.1	12,080.5	9,006.2	– 1.8	– 2.9	+26.9	+31.8
Denmark (OMXCB)	372.6	377.8	257.8	– 0.7	– 1.4	+44.5	+26.6
France (SBF 250)	3,442.4	3,510.4	2,633.6	– 1.9	–21.6	+30.7	+14.9
(CAC 40)	4,895.1	4,999.4	3,816.1	– 2.1	–29.3	+28.1	+12.6
Germany (DAX)*	5,666.4	5,726.5	4,178.1	– 1.0	–29.7	+33.1	+17.1
Italy (S&P/MIB)	36,650.0	36,967.0	30,645.0	– 0.9	–26.9	+18.6	+ 4.3
Japan (Nikkei 225)	16,272.7	16,747.8	10,825.4	– 1.3	–58.2	+41.6	+22.4
(Topix)	1,671.4	1,713.5	1,109.2	– 1.3	–42.1	+45.4	+25.6
Netherlands (AEX)	452.6	455.7	347.0	– 0.7	–35.5	+30.0	+14.3
Spain (Madrid SE)	1,211.9	1,213.7	950.9	– 0.1	– 0.1	+26.4	+11.1
Sweden (Affarsvarlden Gen)	298.5	300.2	218.9	– 0.6	–25.4	+34.9	+15.7
Switzerland (Swiss Market)	7,831.9	7,840.8	5,669.6	– 0.1	– 6.9	+37.6	+20.3
United States (DJIA)	10,858.6	11,043.4	10,012.4	– 0.9	– 7.4	+ 0.7	+ 0.7
(S&P 500)	1,265.7	1,294.2	1,137.5	– 1.3	–17.1	+ 4.4	+ 4.4
(NASDAQ Comp)	2,267.0	2,331.4	1,904.2	– 1.9	–55.1	+ 4.2	+ 4.2
Europe (FTSEurofirst 300)†	1,315.8	1,333.3	1,038.6	– 1.3	–22.8	+26.3	+11.0
Euro area (FTSE Euro 100)†	1,123.7	1,136.3	894.4	– 1.1	–27.5	+24.7	+ 9.7
World (MSCI)‡	1,288.6	1,314.6	1,115.0	– 2.0	–11.1	+10.2	+10.2
World bond market (Citigroup)††	620.2	662.3	608.7	– 0.8	– 6.4	– 6.9	– 6.9

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 9th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Feb 8th	year ago	Currency units per $ Feb 8th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 13.6	Dec	− 43.5	Q3	− 5.9	− 5.3	117.6	115.1	1.35	1.30	2.36	1.62	1.14	+ 1.0
Austria	− 2.1	Nov	− 0.4	Nov	nil	+ 0.1	103.7§	105.3	0.84	0.78	1.46	–	0.71	− 2.0
Belgium	+ 14.2	Nov	+ 8.2	Sep	+ 1.8	+ 2.0	104.2§	106.2	0.84	0.78	1.46	–	0.71	nil
Britain	−116.9	Nov	− 40.6	Q3	− 2.0	− 2.3	97.9	99.8	0.57	0.54	–	0.69	0.48	− 3.1
Canada	+ 52.7	Nov	+ 19.6	Q3	+ 1.9	+ 1.8	126.1	114.7	1.15	1.25	2.01	1.38	0.97	+ 1.3
Denmark	+ 9.6	Dec	+ 8.7	Dec	+ 3.2	+ 3.0	105.7	106.4	6.25	5.82	10.9	7.47	5.27	+ 2.8
France	− 31.6	Nov	− 34.6	Nov	− 1.3	− 1.2	106.7§	109.0	0.84	0.78	1.46	–	0.71	− 3.2
Germany	+200.0	Dec	+112.8	Dec	+ 4.0	+ 3.8	104.4§	107.0	0.84	0.78	1.46	–	0.71	− 3.9
Italy	− 11.8	Nov	− 28.9	Nov	− 1.5	− 1.4	76.4§	78.0	0.84	0.78	1.46	–	0.71	− 4.3
Japan	+ 97.6	Nov	+164.7	Nov	+ 3.5	+ 3.6	81.2	88.8	119	106	207	142	–	− 6.5
Netherlands	+ 39.3	Nov	+ 44.3	Q3	+ 5.0	+ 5.0	103.7§	105.7	0.84	0.78	1.46	–	0.71	− 1.6
Spain	− 96.4	Nov	− 82.6	Oct	− 6.7	− 6.9	77.1§	78.2	0.84	0.78	1.46	–	0.71	+ 0.3
Sweden	+ 19.3	Dec	+ 24.2	Q3	+ 7.0	+ 6.8	96.9	99.9	7.75	7.09	13.5	9.26	6.54	+ 1.2
Switzerland	+ 6.7	Dec	+ 49.3	Q3	+13.5	+13.4	106.3	106.6	1.30	1.22	2.27	1.55	1.10	− 1.6
United States	−772.7	Nov	−780.6	Q3	− 6.5	− 6.6	87.1	83.3	–	–	1.74	1.20	0.84	− 3.7
Euro area	+ 35.9	Nov	− 26.3	Nov	− 0.1	− 0.1	116.1	117.7	0.84	0.78	1.46	–	0.71	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.4	Nov	+ 6.8	Nov	na	na	81.4§	82.9	0.84	0.78	1.46	–	0.71	+ 2.1
Greece	− 34.1	Nov	− 17.0	Nov	na	na	59.8§	60.6	0.84	0.78	1.46	–	0.71	− 4.5
Iceland	− 1.5	Nov	− 2.2	Q3	na	na	113.6**	96.6	63.0	63.3	110	75.3	53.1	+ 2.0
Ireland	+ 40.6	Nov	− 3.7	Q3	na	na	93.7§	97.1	0.84	0.78	1.46	–	0.71	− 0.9
Luxembourg	− 4.8	Nov	+ 3.5	Q3	na	na	104.2§	106.2	0.84	0.78	1.46	–	0.71	− 2.3
New Zealand	− 4.5	Dec	− 9.1	Q3	na	na	136.8	133.7	1.48	1.42	2.57	1.76	1.24	+ 5.3
Norway	+ 47.8	Dec	+ 43.7	Q3	na	na	108.6	104.4	6.73	6.55	11.7	8.04	5.67	+ 15.3
Portugal	− 23.3	Nov	− 16.7	Nov	na	na	93.7**	94.0	0.84	0.78	1.46	–	0.71	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate.
**IMF, October average.

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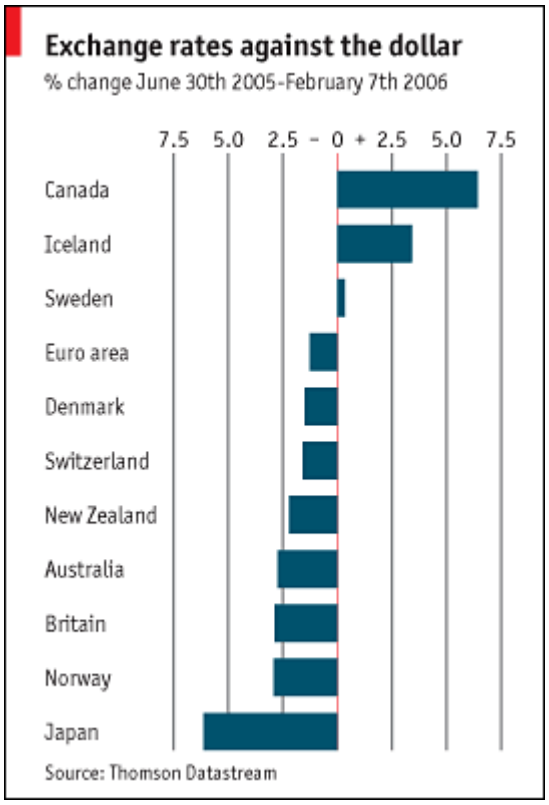
Exchange rates against the dollar

Feb 9th 2006
From The Economist print edition



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Overview

Feb 9th 2006
From The Economist print edition

Brazil's industrial production grew by 3.2% in the year to December, down from 8.3% in 2004. **Pakistan's** industrial output jumped by 19.3% in the year to September, more than in any other economy in the table—though its figures are the most out of date.

Russia's foreign reserves rose to $181.4 billion in January, up 50% from their level a year earlier. Russia now has the emerging world's fourth-largest reserves, behind China, Taiwan and South Korea.

Argentina's 12-month rate of consumer-price inflation was 12.1% in January, double its pace at the end of 2004.

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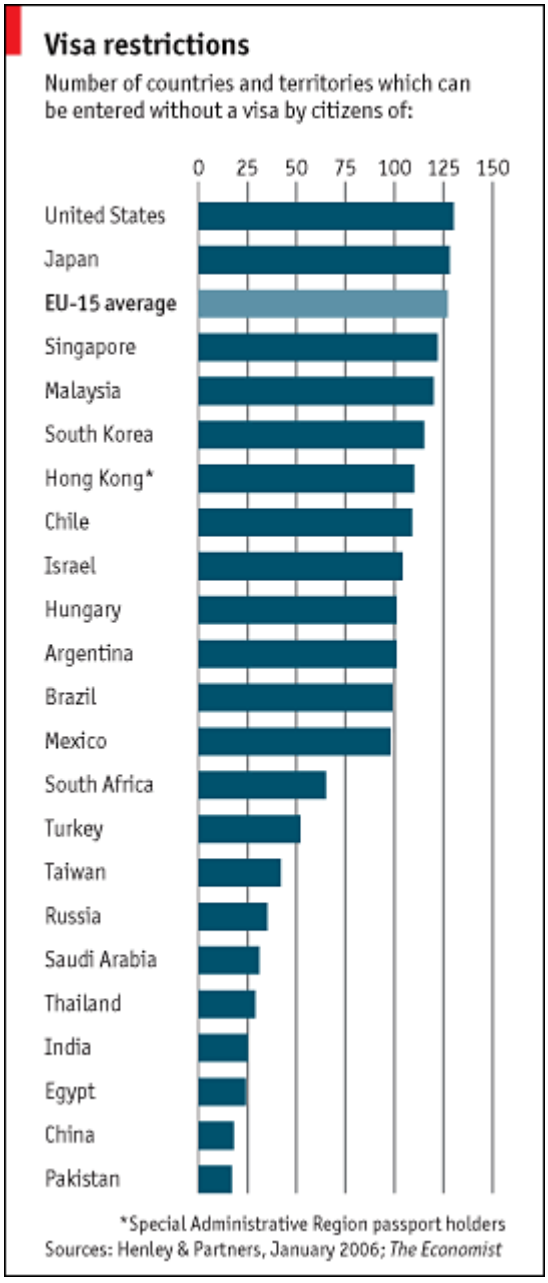
Visa restrictions

Feb 9th 2006
From The Economist print edition

Americans, Finns and Danes can travel to 130 countries without a visa, according to Henley & Partners, which advises individuals where to live and companies where to be located. Pakistanis enjoy less freedom to roam: only 17 countries will admit them without a visa. South Koreans can visit 115 countries visa-free, while North Koreans could visit 18—if only their regime would let them.



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Economy

Feb 9th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.5	Dec	+ 1.6	Dec	+102.1	Dec	+128.5	H1	818.9	Dec
Hong Kong	+ 8.2	Q3	+ 4.1	Q3	+ 1.8	Dec	–10.5	Dec	+21.0	Q3	127.8	Jan
India	+ 8.0	Q3	+ 6.9	Nov	+ 5.6	Dec	–37.4	Dec	–18.3	Q3	131.0	Dec
Indonesia	+ 5.3	Q3	+11.3	Nov	+17.0	Jan	+27.8	Dec	+ 0.7	Q3	33.1	Dec
Malaysia	+ 5.3	Q3	+ 4.2	Dec	+ 3.5	Dec	+25.6	Nov	+18.7	Q3	69.9	Dec
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 8.5	Dec	– 9.3	Dec	– 3.7	Q3	10.0	Dec
Philippines	+ 6.1	Q4	+ 4.0	Nov	+ 6.7	Jan	– 2.6	Nov	+ 2.9	Sep	17.8	Jan
Singapore	+ 7.7	Q4	+ 5.1	Dec	+ 1.3	Dec	+29.6	Dec	+33.7	Q3	120.2	Jan
South Korea	+ 5.2	Q4	+11.3	Dec	+ 2.8	Jan	+21.1	Jan	+16.6	Dec	210.4	Dec
Taiwan	+ 4.4	Q3	+ 9.5	Dec	+ 2.7	Jan	+ 9.6	Jan	+ 8.9	Q3	257.3	Jan
Thailand	+ 5.3	Q3	+ 6.1	Dec	+ 5.9	Jan	– 9.0	Dec	– 3.7	Dec	50.7	Dec
Argentina	+ 9.2	Q3	+ 7.9	Dec	+12.1	Jan	+11.3	Dec	+ 4.4	Q3	25.7	Nov
Brazil	+ 1.0	Q3	+ 3.2	Dec	+ 5.7	Dec	+45.4	Jan	+14.2	Dec	53.2	Dec
Chile	+ 5.2	Q3	+ 6.0	Dec	+ 4.1	Jan	+ 9.2	Jan	– 0.2	Q3	15.9	Jan
Colombia	+ 5.8	Q3	+ 0.6	Nov	+ 4.6	Jan	+ 1.5	Oct	– 1.7	Q3	14.8	Dec
Mexico	+ 3.3	Q3	+ 3.0	Nov	+ 3.3	Dec	– 7.6	Dec	– 8.4	Q3	74.1	Dec
Peru	+ 7.9	Nov	+ 7.6	Nov	+ 1.9	Jan	+ 4.6	Nov	+ 0.8	Q3	13.2	Dec
Venezuela	+ 9.8	Q3	+10.8	Oct	+13.1	Jan	+28.2	Q3	+21.6	Q3	23.4	Nov
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.1	Dec	–11.3	Q3	+ 1.8	Q3	20.8	Jan
Israel	+ 5.7	Q3	+ 3.5	Nov	+ 2.4	Dec	– 7.9	Dec	+ 2.4	Q3	28.3	Jan
Saudi Arabia	+ 6.5	2005‡	na		+ 1.0	Sep	+84.6	2004	+51.9	2004	26.5	Dec
South Africa	+ 4.9	Q3	+ 3.7	Nov	+ 3.6	Dec	– 2.8	Dec	–10.3	Q3	19.9	Jan
Czech Republic	+ 4.9	Q3	+ 7.2	Nov	+ 2.9	Jan	+ 1.8	Dec	– 3.4	Q3	29.5	Jan
Hungary	+ 4.5	Q3	+12.9	Dec	+ 3.3	Dec	– 3.5	Nov	– 8.7	Q3	20.1	Jan
Poland	+ 3.7	Q3	+ 9.2	Dec	+ 0.7	Dec	– 3.1	Nov	– 4.9	Nov	39.8	Dec
Russia	+ 7.0	Q4	+ 4.6	Dec	+10.6	Jan	+117.6	Nov	+81.2	Q3	181.4	Jan
Turkey	+ 7.0	Q3	+10.7	Nov	+ 7.9	Jan	–42.9	Dec	–21.7	Nov	50.5	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.8	Q3	+14.3	Dec	+ 3.6	Dec	– 2.5	Nov	– 1.4	Nov	1.8	Nov
Latvia	+11.4	Q3	+ 5.9	Nov	+ 7.0	Dec	– 2.9	Nov	– 1.9	Nov	2.2	Nov
Lithuania	+ 8.2	Q4	na		+ 3.0	Dec	– 3.6	Nov	– 1.7	Nov	3.5	Nov
Slovakia	+ 6.2	Q3	+ 5.7	Nov	+ 3.7	Dec	– 1.9	Nov	– 2.9	Oct	14.9	Nov
Slovenia	+ 3.7	Q3	+ 7.3	Nov	+ 2.3	Dec	– 1.6	Nov	+ 0.1	Nov	8.0	Oct

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Financial markets

Feb 9th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 8th		Dec 31st 2004	
	Feb 8th	year ago	Feb 8th	% a year		one week	in local currency	in $ terms
China	8.05	8.28	14.0	2.10	1,351.5	+2.5	+ 1.6	+ 4.4
Hong Kong	7.76	7.80	13.5	4.02	15,373.4	-2.3	+ 8.0	+ 8.2
India	44.2	43.7	76.9	6.55	10,044.8	+1.9	+ 52.1	+ 49.7
Indonesia	9,265	9,290	16,136	13.89	1,238.2	-0.2	+ 23.8	+ 24.0
Malaysia	3.73	3.80	6.50	3.31	918.9	+0.5	+ 1.3	+ 3.1
Pakistan	59.9	59.4	104.27	9.01	10,914.6	+4.0	+ 75.5	+ 74.1
Philippines	51.8	54.9	90.1	7.38	2,060.9	-3.9	+ 13.1	+ 22.6
Singapore	1.63	1.65	2.84	3.38	2,428.3	-0.1	+ 17.5	+ 17.7
South Korea	972	1,026	1,692	4.27	1,311.0	-4.7	+ 46.3	+ 55.9
Taiwan	32.3	31.9	56.3	1.65	6,624.1	+1.4	+ 7.9	+ 5.7
Thailand	39.7	38.6	69.2	4.65	734.6	-3.4	+ 10.0	+ 7.5
Argentina	3.08	2.91	5.36	8.50	1,695.0	-3.0	+ 23.2	+ 19.1
Brazil	2.19	2.61	3.82	17.28	36,499.0	-5.2	+ 39.3	+ 68.6
Chile	531	579	925	4.68	9,506.8	-0.2	+ 6.1	+ 11.0
Colombia	2,259	2,357	3,935	6.05	9,951.8	-6.8	+129.0	+138.4
Mexico	10.5	11.2	18.3	7.68	18,410.2	-3.9	+ 42.5	+ 50.9
Peru	3.28	3.26	5.71	3.81	6,114.8	+3.4	+ 64.8	+ 64.9
Venezuela	2,652§	2,763§	4,619	10.90	26,844.9	+4.8	- 10.4	- 12.9
Egypt	5.74	5.81	9.99	8.09	66,042.0	-4.3	+168.6	+184.3
Israel	4.72	4.38	8.21	5.02	826.3	-2.6	+ 28.3	+ 17.6
Saudi Arabia	3.75	3.75	6.53	5.31	19,522.1	+2.4	+137.9	+137.9
South Africa	6.22	6.24	10.8	7.20	19,201.3	-4.2	+ 51.7	+ 37.4
Czech Republic	23.8	23.4	41.5	2.05	1,526.8	+0.7	+ 47.9	+ 38.7
Hungary	211	191	367	6.10	22,256.5	-0.5	+ 51.0	+ 29.6
Poland	3.20	3.13	5.58	4.32	38,162.7	+0.3	+ 43.3	+ 34.0
Russia	28.3	28.1	49.2	12.00	1,335.2‡	-0.3	+121.7	+117.4
Turkey	1.33	1.33	2.32	14.68	43,842.7	-3.1	+ 75.6	+ 78.0
EM (MSCI)*	1.00	1.00	1.74	na	761.2	-3.2	+ 40.4	+ 40.4
EMBI+†	1.00	1.00	1.74	na	374.5	+0.3	+ 13.6	+ 13.6

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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